

**ASSESSMENT OF PUBLIC FINANCE MANAGEMENT
IN MOZAMBIQUE 2004/05**

BASED ON PEFA METHODOLOGY

Final Report

**Current status of PFM systems & processes,
overview of reforms and perspectives for 2006**

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**REPORT TO THE GOVERNMENT OF MOZAMBIQUE
AND TO THE PROGRAMME AID PARTNERS**

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It is submitted as a Final Report, providing an external assessment of the status of Public Finance Management in Mozambique. This assessment is based on the analysis of the team and on the comments received from the Government of Mozambique and the Programme Aid Partners (PAPs) during the two field missions carried out in October and December 2005 respectively. Comments on the draft Final Report submitted in early January 2006 were received from the Ministry of Finance, the *Banco de Moçambique*, the *Tribunal Administrativo*, the Programme Aid Partners and the PEFA Secretariat, and have been duly incorporated.

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Responsibility for the opinions presented in this Report rests exclusively with the authors and should not be attributed to the Government of Mozambique, to the European Commission or the Programme Aid Partners.

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LIST OF ACRONYMS

AfDB	African Development Bank Banco Africano de Desenvolvimento
AGA	Autonomous Government Agencies Instituições Autónomas do Governo
AR	National Assembly Assembleia da República
BER	Budget Execution Report Relatório de Execução Orçamental
CFAA	Country Financial Accountability Assessment Avaliação da Responsabilidade Financeira do País
CFMP	Medium Term Fiscal Framework Cenário Fiscal de Médio Prazo
CGAF	Compte General de l'Administration des Finances Cômputo Geral da Administração Financeira
CGE	General State Accounts (Annual Budget Execution Report) Conta Geral do Estado
COFOG	Classifications of Functions of Government Classificações das Funções do Governo
CPAR	Country Procurement Assessment Review Revisão da Avaliação do Aproveitamento do País
CPD	Data Processing Centre Centro de Processamento de Dados
CUT	Single Treasury Account Conta Única do Tesouro
DAC	Development Assistance Committee (of OECD) Comité de Assistência ao Desenvolvimento (da OCDE)
DAF	Directorate of Administration and Finance (in line ministries) Direcção de Administração e Finanças
DFID	United Kingdom Department for International Development Departamento para o Desenvolvimento Internacional do Reino Unido
DCI	Cooperation and Investment Directorate Direcção de Cooperação e Investimento
DNCP	Public Accounts National Directorate Direcção Nacional de Contabilidade Pública
DNIA	Tax and Customs National Directorate Direcção Nacional de Impostos e Alfandegas
DNO	Budget National Directorate Direcção Nacional do Orçamento
DNPE	National Directorate for State Assets Direcção Nacional do Património do Estado
DNT	Treasury National Directorate Direcção Nacional do Tesouro
EC	European Commission Comissão Europeia
ETSDS	Expenditure Tracking and Service Delivery Survey Pesquisa de Localização da Despesa e Prestação de Serviços
FCA	Autarchic Compensation Fund Fundo de Compensação Autárquica
FIL	Local Initiative Fund Fundo de Iniciativa Local
G-17	Group of General Budget Support Donors Doadores que prestam Apoio Directo ao Orçamento
G-20	Group of Civil Society Organisations Grupo de Organizações da Sociedade Civil
GBS	General Budget Support Apoio Geral ao Orçamento
GFS	Government Financial Statistics

GoM	Estatísticas Financeiras do Governo Government of Mozambique Governo de Moçambique
HIPC AAP	Heavily Indebted Poor Countries Assessment and Action Plan Avaliação e Plano de Acção para Países Pobres Altamente Endividados
IAASB	International Auditing and Assurance Standards Board Conselho de Auditoria Internacional e Controlo de Qualidade
IFAC	International Federation of Accountants Federação Internacional de Contabilidade
IGEPE	Institute for Management of State Corporate Investments Instituto de Gestão de Participações do Estado
IGF	General Inspectorate (Internal Audit) Inspecção-geral de Finanças
IMF	International Monetary Fund Fundo Monetário Internacional
INTOSAI	International Organization of Supreme Audit Institutions Organização Internacional das Instituições Supremas de Auditoria
IPSAS	International Public Sector Accounting Standards Padrões Internacionais de Contabilidade Pública
IRC	Corporate Income Tax Imposto sobre os Rendimentos Coletivos
IRS	Personal Income Tax Imposto sobre os Rendimentos Singulares
ISPPIA	International Standards for the Professional Practice of Internal Auditors Padrões Internacionais de Práticas Profissionais para Auditores Internos
JDR	Joint Donor Review Revisão Conjunta dos Doadores
JR	Joint Review (of PARPA implementation) Revisão Conjunta
MDA	Ministries, Departments and Agencies (Budget-holding entities) Ministérios, Departamentos e Instituições
MEC	Ministry of Education and Culture Ministério de Educação e Cultura
MISAU	Ministry of Health Ministério da Saúde
MF	Ministry of Finance Ministério das Finanças
MoU	Memorandum of Understanding Memorando de Entendimento
MPD	Ministry of Planning and Development Ministério do Plano e Desenvolvimento
MTEF	Medium-Term Expenditure Framework Enquadramento de Meio Prazo das Despesas
OCDE	Organisation for Economic Co-operation and Development Organização para a Cooperação Económica e Desenvolvimento
ODI	Overseas Development Institute
PAF	Performance Assessment Framework Quadro de Avaliação de Desempenho
PAPs	Programme Aid Partners Parceiros de Apoio Programático
PARPA	Poverty Reduction Action Plan Plano de Acção para a Redução da Pobreza Absoluta
PE	Public Enterprise Empresa Pública
PEFA	Public Expenditure and Financial Accountability Despesa Pública e Contabilidade Financeira
PER	Public Expenditure Review Revisão das Despesas Públicas
PES	Social and Economic Plan Plano Económico e Social

PETS	Public Expenditure Tracking Survey Pesquisa de Localização das Despesas Públicas
PFM	Public Finance Management Gestão das Finanças Públicas / Gestão Financeira Pública
PFM-PR	PFM Performance Report Relatório de Desempenho da GFP
PI	Performance Indicator Indicador de Desempenho
PRGF	Poverty Reduction & Growth Facility (IMF) Redução de Pobreza & Facilidades de Crescimento (FMI)
PRSC	Poverty Reduction Support Credit (World Bank) Crédito para Apoio à Redução da Pobreza (Banco Mundial)
RA	Revenue Administration Administração Tributária
ROSC	Report on Standards & Codes (IMF diagnostic report on PFM) Relatório de Padrões e Códigos (FMI Relatório de Diagnóstico da GFP)
SA	Standardized Assessment Avaliação Padrão
SAI	Supreme Audit Institution Instituição de Auditoria Suprema
SAL	SAL Consultoria e Investimentos Lda.
SDC	Swiss Development Cooperation Cooperação Suíça
Sida	Swedish International Development Cooperation Agency Agência Sueca para o Desenvolvimento Internacional e Cooperação
SISTAFE	State Financial Administration System Sistema de Administração Financeira do Estado
SN	Sub-National (Government) Sub-Nacional (Governo)
SWAP	Sector-Wide Approach Programme Programa de Abordagem dos Sectores
TA	Mozambique Supreme Audit Institution / Administrative Court Tribunal Administrativo
UN	United Nations Nações Unidas
UNDP	United Nations Development Programme Programa das Nações Unidas para o Desenvolvimento
URTI	Technical Unit for Internal Revenue Reform Unidade de Reforma Tributária dos Impostos Internos
UTRAFE	Technical Unit for State Financial Administration Reform Unidade Técnica das Reformas da Administração Financeira do Estado
UTRESP	Technical Unit for Public Sector Reform Unidade Técnica de Reforma do Sector Público

SUMMARY ASSESSMENT

This report provides a ranking of the current status of the PFM systems and processes of Mozambique, following the PEFA methodology. It includes a description of past and current PFM reforms, an overview of their impact over 1995 to the present and an assessment of likely progress up to the end of 2006. It is submitted as a final report for approval by the Government of Mozambique and its Programme Aid Partners (PAPs).

The assessment presents a snapshot of the status of PFM systems and processes up to the conclusion of the 2004 budget cycle, taking account of the accounting and audit information on past year expenditures produced during 2005¹. The objective has been to generate a benchmark against which to track progress in PFM performance over future years and to permit comparisons with other countries undertaking PEFA assessments. This benchmark assessment should provide a basis for Government to review the current programme of PFM reforms and to consider whether there is a need to re-evaluate priorities and adjust the focus of current efforts. It also constitutes one element in the monitoring of progress in the use of budget support, feeding into the Performance Assessment Framework (PAF) agreed between the PAPs and Government for this purpose.

(i) Context for the Assessment: the reform process 1995 – 2005

It is important to place this snapshot of the status of PFM performance within its proper context. Mozambique is a Developing Country with serious human resource and capacity limitations. It is also a young country, still in the early stages of institution building after the protracted and damaging civil war which followed Independence. It is inevitable that it will exhibit significant weaknesses in its PFM systems. However, there is no doubt that over the ten year period from 1995 there have been major improvements in PFM systems, which have served to establish the essential legal and institutional structure for public finance management.

The process of PFM reform entered a complicated phase in the period from 2001 to the present, in particular with the initiation of the design and implementation of the SISTAFE integrated financial management system. The IMF HIPC tracking Assessment & Action Plan (AAP) exercises undertaken in 2001 and 2004 suggest that there were no noticeable improvements between the two studies: in fact in 2004 only 4 out of 16 benchmark scores were attained as compared with 5 out of 15 in 2001. The HIPC AAP methodology is relatively simple and may perhaps have failed to capture certain areas of improvement – indeed the 2004 report was never finalised due to a failure to reach agreement with Government over its factual content. Yet the fiduciary assessments carried out in 2002 and 2003 as well as the UTRAFE reports provide further justification for characterising this as a period in which reforms progressed but had a relatively limited impact on the level of PFM performance. There are several factors underlying this phenomenon, of which we would highlight two:

¹ The only exception is indicator PI-11, for which information regarding the formulation of the 2005 budget was utilised.

- In the first place, this was a period characterised by the extensive design work which took place for the introduction of the SISTAFE systems of expenditure control, accounting and reporting. It also saw a heavy emphasis on legislative revisions. Whilst crucially important to the achievement of systemic improvements over the longer term, these efforts did not, by their very nature, yield immediate gains in the quality of PFM outcomes.
- Secondly, there was a diminished political focus on PFM reforms as broader developmental and policy concerns demanded attention, with the aftermath of the floods and the HIPC accession requirements dominating the earlier years of the period and the preparations for the 2004 elections the latter years.

These factors can be seen to represent an additional ‘transitional constraint’ over and above the basic problems of limited managerial and technical capabilities. Fortunately, with SISTAFE design processes now well advanced, a new Government in place and a GBS funding and management process in place, these short-term constraints have now been largely overcome.

(ii) *Integrated assessment of PFM performance at end of 2004*

The assessment of PFM performance at the end of 2004 is presented in Chapter 3 of this report. It shows that improvements are being made in a number of important areas and that these are beginning to have an impact. Overall, the budget is a credible document – in the sense that final out-turns are reasonably close to the initial approved budget. This is particularly true at the aggregate level and shows that the information generated by the PFM system and the in-built controls which it embodies are at least sufficient to ensure aggregate fiscal discipline. This is an essential first requirement of any PFM system and is also reflected in the generally sound macro-economic performance of Mozambique. The steady improvements in the effectiveness of revenue collection and administration are also highly relevant to this objective.

Budgetary institutions have been developing and are beginning to generate the right sort of links between government policy, its resource allocation decisions and final service delivery results. The process of annual budget formulation is linked to plan formulation (preparation of the annual *PES*) and, in turn derives from a wider fiscal strategy (the *CFMP*) and an overall set of government objectives (the *PARPA*). Links between these four elements are not as coherent and consistent as they should be but their respective roles are defined in law and the challenge of improving coherence is steadily being addressed. There is a clear budget calendar in the SISTAFE Law and regulations. Apart from occasional delays, this calendar is generally followed, and gives budget entities two months to prepare detailed budget proposals. The process of legislative scrutiny of the Budget is now well established and conforms closely to international good practice norms, although there is still only limited evidence of a serious ‘challenge’ function played by Parliament. Systems of accounting and reporting are also steadily improving, albeit from a low base.

Yet, there remain some fundamental weaknesses in the quality of PFM systems, which seriously undermine the ability of the Government of Mozambique to ensure that resources are allocated to defined priorities and to guarantee that there is value for money in public spending. Especially worrying are the weaknesses in internal control systems – control over the payroll, over expenditure commitments and over procurement processes.

Regarding payroll controls, there is at present no independent basis for a central reconciliation of the payroll and personnel records, because the *Sistema Integrado do Pessoal* in MAE is not fully updated. There are 12 payrolls at the national level and no integrated payroll list. Delays in processing changes are often significantly longer than three months and require widespread retroactive adjustments. These weak central controls create real possibilities for “ghost workers” and for staff to receive pay from more than one payroll. In 2004, personnel costs represented over 40 % of total budgeted expenditures so the seriousness of these weaknesses cannot be overstated.

Internal controls for non-salary expenditure are weak because expenditure commitment controls are lacking at central level. Budget entities have a set of procedures to record expenditure commitments but there is no requirement to report commitments to the central level and hence they are not reflected in budget execution reports. There is also widespread anecdotal evidence that commitment controls are not systematically applied even within budget entities.

With regard to procurement, the data available in the DNPE Activity Plan/ *Balanço Annual* show that less than 50% of contracts above the national threshold for small purchases are awarded on an open competitive basis. Although regulatory requirements establish that open competition should be the preferred method of competition, it is frequently argued that the list of official suppliers does not present sufficient options to meet requirements and/ or that the technical specification of goods is so high that open competition is impractical. Such arguments may occasionally be valid, yet it is these single supplier arrangements that offer the greatest scope for corrupt practices.

The quality of Internal Audit is improving and is helping spending agencies to identify how to improve their own control systems. Yet in the absence of robust central systems of control, the impact of internal audit can only be modest.

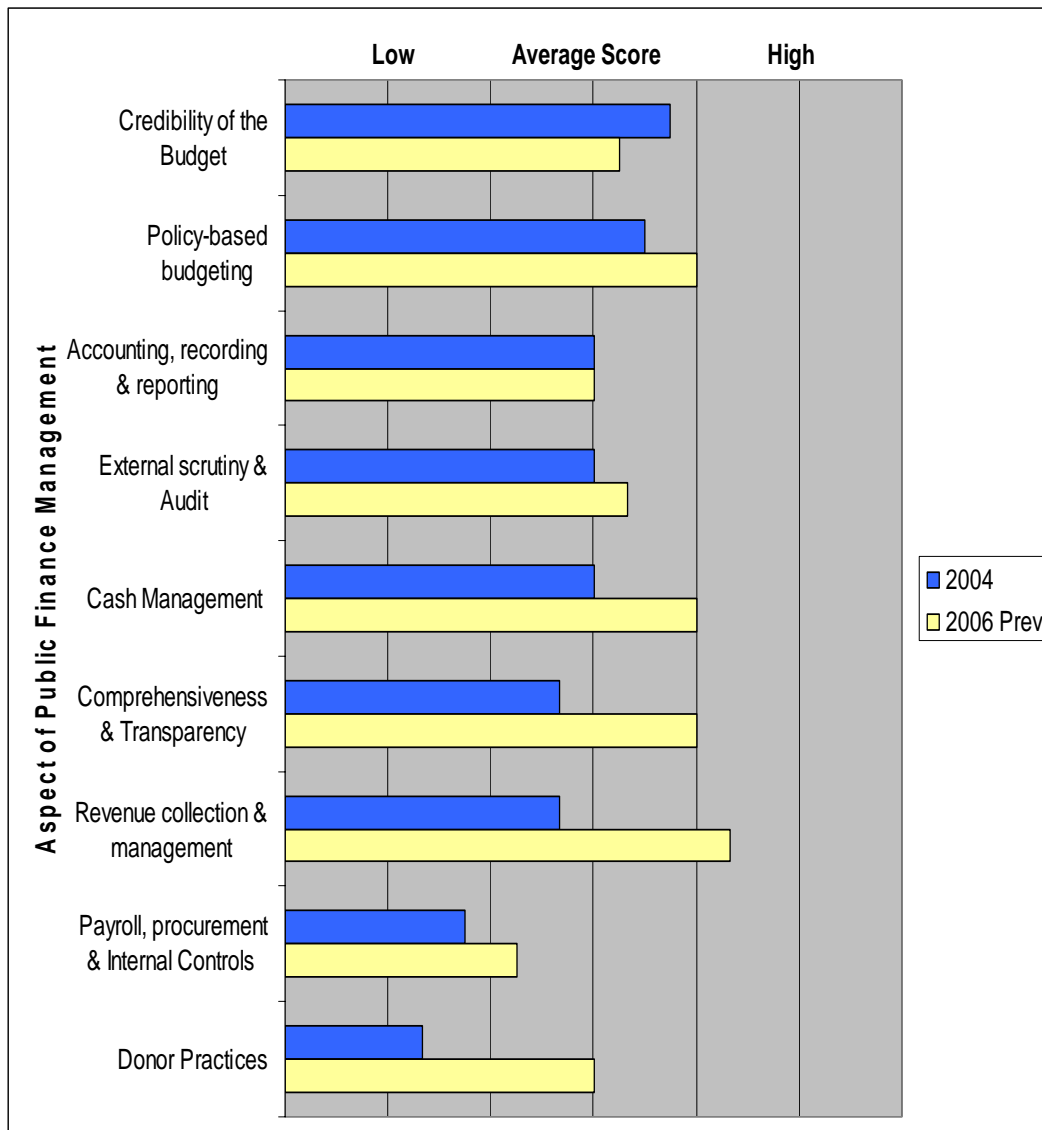
The limited coverage of external audit is also an area of concern. Capacity in this area is extremely limited and, as a result, only a quarter of government entities can be audited annually. However, audit functions are primarily aimed at re-inforcing existing systems of internal control and at re-inforcing the incentives to achieve value for money. Clearly, capacity for external audit must continue to be strengthened but the basic mechanisms of control must be seen as the greatest priority in the short term.

The high levels of off budget spending – financed both from departmental revenues (*receitas proprias*) but more particularly from external project finance – continue to create problems for the integrity of the budget and for the effectiveness of treasury management systems. Essentially, Mozambique continues to borrow money from the domestic market unnecessarily and at high cost because there are unused project balances sitting idle outside of the treasury mechanism². Off-budget projects also undermine the ability to plan strategically and to cater for recurrent costs effectively. Given the emphasis on harmonisation and alignment, this is especially disappointing and reflects poorly on Mozambique’s

² If external projects were to be channelled through the Treasury Single Account (*CUT*), undisbursed project balances would remain earmarked but they would be counted by the Bank of Mozambique as Treasury balances to be included as credit items within the Net Position of Government. As such they could be offset against debit items in other sub-accounts of *CUT*, minimising the need for drawing overdraft facilities from the Central Bank and/ or issuing of Treasury Bills.

Development Partners. Rhetoric needs to be turned urgently into concrete actions to improve donor practices and raise the predictability of both budget and project support to the Government of Mozambique. During 2004 and 2005, a number of actions have been initiated to address this problem, most notably the creation of a Government-Donor Task Force on off-budget spending and the development of a project data-base covering all support from EU Member States to Mozambique. It is essential that this work should be intensified during 2006.

Figure 1: Overview of 2004 PEFA scores and identified ‘potential scores’ for 2006³



³ This graph was obtained by assigning a numerical value (from 1 to 7) to each possible score in the PEFA methodology (from D to A), and then averaging the numerical values of the scores obtained in the indicators for each area or sub-area of the methodology. Although this kind of graphical representation is not foreseen in the methodology itself, the authors deemed it useful to present an overall view of results and trends.

(iii) *Perspectives up to end 2006*

There is no doubt that the quality of the PFM system continues to improve and over many of the indicators, we saw the potential for concrete gains even in the short term. This is illustrated in Figure 1, above, which shows the average scores in 2004 for each area of assessment, compared with the team's judgement of potential scores for 2006. Annex Two presents the team's estimates of the potential scores for each of the 31 indicators for 2006. These should be interpreted as an indication of the scale of improvements that might in principle be possible, if existing reforms were to proceed as planned and additional short-term actions were implemented, without any setbacks being suffered. It would not be appropriate for these potential scores to be interpreted as firm targets, given the optimistic assumptions on which they are based.

In some cases, the expected improvements will be the natural consequence of ongoing reforms, such as e-SISTAFE, which is already improving the quality of bank reconciliation and financial reporting processes. The assessment also identified a number of areas where 'quick gains' in the quality of PFM outcomes could be attained through relatively simple improvements to existing processes. For example, the presentation of the budget framework and CFMP to Cabinet or the development of a consolidated fiscal risk analysis would both be reasonably straightforward to implement during 2006. In other cases, such as in relation to payroll controls, the gaps are more complicated to resolve but too serious to leave un-addressed. It will be important that coherent reforms are developed to address these weaknesses.

Accordingly, we strongly recommend the organization of a management workshop early in February 2006 where the Ministries of Finance and Planning together with the *Tribunal Administrativo*, UTRAFE and UTRESP could contemplate the results of the PEFA exercise and assess its implications for the current design of reforms. Table 2 of Chapter 4 illustrates the types of reform measures which this workshop may need to contemplate in order to achieve both 'quick wins' in the quality of PFM outcomes, as well as longer term systemic improvements. Clearly, the management of reform actions across such a wide range of areas will represent a challenge for Government. The review workshop should therefore also consider how to build upon and strengthen the existing PFM reform coordination arrangements⁴.

⁴ This workshop was indeed held in February 2006 and a resulting short-term action plan was developed and agreed by the relevant government institutions.

1 INTRODUCTION

1. This document comprises the Final Report of the 2004/05 Assessment of Public Finance Management in Mozambique. It has been approved by the Government of Mozambique and the Programme Aid Partners and has also been peer reviewed by the PEFA Secretariat in Washington DC. It has been revised during March 2006 in the light of comments received on the draft final report, submitted in January 2006.

2. The Report provides a ranking of the current status of the PFM systems and processes of Mozambique up to the end of the 2004 budget cycle⁵, following the PEFA methodology. It includes a description of past and current PFM reforms, an overview of their impact over 1995 to the present and an assessment of likely progress up to the end of 2006. The assessment has been undertaken by a team of consultants from the Overseas Development Institute (London) and SAL Consultoria e Investimentos Lda (Maputo), with the close support of the *Inspecção Geral das Finanças* (IGF) of the Ministry of Finance, Government of Mozambique.

3. The main GoM partner for the PFM Assessment has been the Ministry of Finance, who nominated IGF as the government focal point for the process. IGF has coordinated Government's participation and input into the PFM Assessment. All relevant government actors have been involved from the beginning of the exercise. Beyond IGF, these included other key departments in the Ministry of Finance, the newly created Ministry of Planning and Development, the *Tribunal Administrativo*, the *Inspecção Geral do Estado* in the Ministry of State Administration and the *Banco de Moçambique*. A reference group was established, drawn from the above GoM institutions, from the EC and from three other members of the Programme Aid Partners group (Germany, the Netherlands and Sweden). This reference group was formally tasked with managing the PEFA assessment exercise and was briefed on a weekly basis by the study team.

4. The study team also organised an inception workshop for national stakeholders on Friday 14 October, in order to explain the concept of PFM and its importance for public sector development in Mozambique, and to provide a detailed description of the Standardised Assessment approach and of the PEFA PFM Performance Measurement Framework. In addition, briefings were organised for the *Conselho Técnico* of the Ministry of Finance and for the PAPs.

5. A second workshop was organised in Maputo for the study Reference Group on the morning of Tuesday 6th, December, 2005. Here, comments on the Preliminary Assessment were discussed, and the minor outstanding disagreements on the PFM benchmarking exercise were addressed. A wider presentation of the results of the exercise was then made on the afternoon of Tuesday 6th, December. This Final Report incorporates the results of these discussions, as well as subsequent written comments received on the draft Final Report.

⁵ The assessment has made use of the accounting and audit information which has been submitted during 2005 referring to earlier fiscal years. However, as the majority of the PEFA indicators require analysis of information from a complete budget cycle, the assessment is best considered as representing the status of systems at end 2004. The only exception is indicator PI-11, for which information on the formulation of the 2005 budget was utilised, even though this did take place in 2004.

2 COUNTRY BACKGROUND

2.1 Economic Situation

6. Mozambique is a post-conflict, coastal country in Southern Africa. In 2003, it had a population of 18.8 million and estimated per capita GDP of US \$258⁶. Over 1995 – 2005, it achieved remarkable improvements in its economic performance, supported by substantial donor assistance. Real GDP growth averaged 8 % per year over the period (6 % in per capita terms), which permitted a reduction in the proportion of the population living in absolute poverty from 69 % in 1996/97 to 54 % in 2002/03.

7. This was matched by major structural improvements in the macroeconomic situation. Inflation fell to single digit levels (and remained at 4.5 % p.a. in April 2005, despite rising oil prices); there was a major reduction of public external debt under the HIPC initiative (with the Net Present Value of debt falling from over 500% of exports at end-1998 to less than 100% in 2003) and the international reserves position was considerably strengthened. These achievements were facilitated by a stable political situation and by the consolidation of the democratic system, as illustrated by the general elections of December 2004, which took place peacefully.

8. The main drivers of economic growth have been export earnings – in particular from “mega-projects” for bauxite smelting and titanium ore extraction, as well as growth in agriculture and in services. The contribution of mega-projects to GDP rose from zero in 1995 to 7 % in 2003 and continues to grow. The agriculture sector has shown steady growth, averaging 5.6 % over 1992 – 2003, despite the devastation caused by the major floods of 2000. In large part, this has been due to an expansion of the area under cultivation but there have also been productivity gains. Parts of the private formal sector have also grown very fast, notably transport, services, communications and mining.

9. The contribution of mega-projects to poverty reduction has been minimal because employment creation has been negligible (due to high capital intensity) and fiscal contributions have also been low, due to the highly favourable tax regime. Steady agriculture sector growth has been the main contributor to poverty reduction, as 80% of the population continue to be dependent on agriculture. Rural–urban migration has also been high and, while this may have eased the pressure on resources in rural areas and may also have been a source of increased cash income through urban-rural remittances, there are indications that informal sector earnings have stagnated as a result. As a whole urban poverty has fallen more slowly than rural poverty. Government and donor financing of basic services has led to steady improvements in access and in the quality of education, health and road services.

10. Nevertheless, important weaknesses and vulnerabilities remain. Growth and poverty reduction have been impressive but from a low base and the numbers of people in absolute poverty remain very high. Moreover, there are reasons to believe that the “easy gains” from the re-establishment of peace, stability and growth have largely been taken and that continued fast growth will require substantial improvements in infrastructure as well as further

⁶ These data and much of the material for Chapter 2 are drawn from IMF, Report of the 2005 Article IV Consultations, September 2005.

structural reforms. These reforms will need to take place against a difficult social backdrop, with HIV prevalence rates continuing to rise within key population groups (such as females of 15-24) and life expectancy rates remaining stubbornly stagnant at 40 years, having fallen from 44.6 years in 1995.

11. The Government is coordinating the preparation of a new poverty reduction strategy, the *Plano de Acção para Redução da Pobreza Absoluta 2006 – 2010*, which is expected to be completed in early 2006. This is likely to concentrate on four key areas:

- Improvements to the business environment, in particular the development of a more accountable judicial system, a transparent regulatory framework and improved credit access, resulting from the modernisation of land-use rights and the promotion of micro credit;
- Accelerated rural development, through improved infrastructure, enhanced market access and better administration of local service provision;
- Improved basic service provision, focused on particular on issues of quality and efficiency; and
- Improved governance, in particular reduced corruption and closer attention to improving those aspects of public administration which have most impact on growth and poverty reduction.

12. Underlying this strategic thrust is an ongoing programme of civil service reform, was one of the key elements of the 2000 – 2004 five-year plan and continues to be implemented with World Bank support. Fundamentally, this is aimed at modernising the civil service and continuing the steady shift away from the centralised public sector model which dominated over 1975-1995. It includes six broad components:

- Clarifying the role of the public sector;
- Decentralization and deconcentration;
- Improved management of public policy processes;
- Human resources development;
- Enhanced financial management; and
- Good governance and the fight against corruption.

13. The financial management component has focused in particular on the development of the e-SISTAFE system of integrated financial management. Over 2001 – 2005 this has been the dominant thrust within the process of PFM reform, alongside reforms in revenue management, actions to improve links between the PARPA, planning systems and the budget and steps to reduce the high levels of off-budget spending.

2.2 Budgetary Outcomes 2000 – 2004

14. Mozambique has been able to maintain a reputation for sound macroeconomic management and for strong aggregate fiscal discipline. There was some relaxation in the fiscal stance leading up to the 2004 elections but the indications are that tighter control over the fiscal deficit has been restored in 2005. However, Mozambique has only been able to control its internal public sector borrowing requirements through a high level of dependence on external grant aid and concessional loan financing. More than 50% of total public expenditure is foreign financed and attempts to reduce this level of aid dependence through revenue reforms have had limited success. This can be seen in the table below. The aggregate fiscal deficit after grants has remained below 5% of GDP, with the exception of 2002 when the effects of the 2000 and 2001 floods were still being felt. But this masks the very high fiscal deficit before grants which even in 2004 remains over 11 per cent of GDP.

Mozambique Central Government Budget (as a % of GDP)

	2002	2003	2004
Total Revenue	26.0	22.4	19.6
Own revenue	14.2	12.9	12.3
Grants	11.8	9.5	7.3
Total Expenditure	34.1	26.5	23.7
Non-interest expenditure	32.6	25.3	22.7
Interest expenditure	1.5	1.2	1.0
Aggregate deficit (after grants)	8.1	4.1	4.1
Primary fiscal deficit	6.6	2.9	3.1
Net financing	7.2	4.3	2.3
External	6.3	4.2	2.8
Domestic	0.9	0.1	-0.5
Aggregate deficit (before grants)	19.9	13.6	11.4

Source: IMF, Article IV Consultations, 2003 & 2005.

15. Although tax structures and regulatory systems have been modernised, this has not led to a widening of the tax base nor to a significant improvement in the efficiency of collections. The high level of tax exemptions, particularly for mega-projects, prevents the expansion of the tax base. Meanwhile, there are high levels of non-compliance and significant inefficiencies in tax enforcement. In 2005, the revenue reform process has focused explicitly on improving tax enforcement but substantial institutional strengthening and capacity development is likely to be required before a significant impact can be expected. Thus, the tax to GDP ratio has remained largely stagnant at around 12% of GDP⁷.

⁷ This is especially noticeable in applying the new GDP series issued by the National Institute of Statistics in May 2005. Due to delays in data production, the authorities had since 2000 relied on estimates of GDP produced by the Ministry of Finance. These appear to have under-estimated GDP by some 10 per cent, creating the illusion of a steady improvement in the tax to GDP ratio. See IMF, Sept 2005.

Actual budgetary spending by priority sectors (as a % of total non-interest expenditure)

	2002	2003	2004
Education	18	20.2	20.9
Health	12.6	10.6	10.5
HIV/AIDS	0.8	0.3	0.4
Infrastructure	16.5	13.9	13.2
Agriculture and Rural Development	5.3	4.9	4.4
Governance and Justice	8.1	9.4	9.7
Other priority sectors	4.1	4.1	3.9
Sub-total priority sectors	65.4	63.4	63

Source: Government of Mozambique

16. In terms of resource allocation, Government has placed a priority on the allocation of resources to the identified PARPA priority sectors. An overall target of allocating 65% of total non-interest expenditure was established in the PARPA and agreed with the PAPs as a benchmark within the Performance Assessment Framework. In terms of approved budget allocations, the benchmark has been met but in terms of actual expenditures, Government has struggled to meet this target as shown in the table above. In large part, this has been due to constraints of absorptive capacity but it seems that this problem has been significantly exacerbated by the continued high levels of off-budget spending and by the difficulties that creates in treasury management.

17. In terms of the economic composition of spending, recent years have seen a significant increase in spending on wages and salaries. In part, this is due to improvements in remunerations resulting from salary reforms and in part to the expanded recruitment of education and health staff. Both of these measures have been necessary and are clearly consistent with the policy thrusts of the PARPA and the civil service reform programme. However, as recurrent costs rise so the issue of aid dependence begins to assume greater importance. Wages and salaries already comprise over 10 per cent of GDP and while they can continue to be covered by domestic revenues, it would require drastic cuts in transfers and non-salary spending if for any reason budgetary support was to be suspended. Again this underlines the importance of improving revenue generation and finding ways of increasing the efficiency of service delivery so as to minimise further expansion of recurrent costs.

Actual budgetary allocations by economic classification (as a % of total expenditure)

	2002	2003	2004
Current expenditures	83.9	86.3	86.0
Wages and Salaries	38.6	41.3	42.4
Goods and Services	19.1	18.2	18.6
Interest Payments	16.1	16.0	15.8
Transfers	7.5	7.3	5.5
Others	2.6	3.4	3.7
Capital Expenditures	16.1	13.7	14.0

Source: Government of Mozambique

Note: Excludes externally-financed capital expenditure

2.3 Legal & Institutional Framework for PFM

18. The legal framework for the management of public finances consists of four groups of laws and regulations, relating to:

- The SISTAFE system for the management of State finances
- The *Tribunal Administrativo* and its role as the supreme audit institution.
- The framework for decentralised, autonomous financial management within the Municipalities; and
- The local government framework of deconcentrated management within provinces and districts.

Box 1 Legal Framework for Public Finance Management in Mozambique

The legal framework for PFM is governed by the following laws and regulations:

- Law n° 9/2002, of 12 February, which approves the State Financial Administration System (*Sistema de Administração Financeira do Estado*, colloquially the “SISTAFE”);
- Decree n° 23/2004, of 20 August, which approves the SISTAFE Regulations;
- Law n° 5/92, of 6 May, which defines the role of the *Tribunal Administrativo*;
- Law n° 13/97, of 10 July, which establishes the regime for the audit and inspection of public expenditures by the *Tribunal Administrativo*;
- Law n° 2/97, of 18 February, which defines the role of the Municipalities;
- Law n° 11/97, of 31 May, which constitutes the legal regime for the finances and assets of the Municipalities;
- Law n° 8/2003, of 19 May, the Local Government Law (relating to districts and provinces); and
- Decree n° 13/2005, of 10 June, the Local Government Law Regulations.

2.3.1 SISTAFE Law and Regulations

19. The approval of SISTAFE was the result of the reform of the financial administration system inherited from the colonial administration, in order to introduce legislation and management models more adequate to the needs of a modern public administration. SISTAFE establishes and harmonizes rules and procedures in relation to the programming, management, execution and control of the state public treasury, and the financial administration of state agencies and institutions. It is applicable to all state agencies and institutions, including those with financial and administrative autonomy. It is also applicable to public companies (*empresas do Estado*) and municipalities, except in relation to the rendering of accounts, which is governed by specific legislation.

20. SISTAFE is organized in 5 subsystems:

- The State **Budget Subsystem**, which governs the preparation of the State Budget, the preparation of the budget bill for submission to the Legislature; and the evaluation of the budget submissions of state agencies and institutions.

- The **Public Accounting Subsystem**, which has as its object the production and the maintenance of the records of transactions carried out by state agencies and institutions, and their effects on the State's assets. Among other things, it governs the execution of the State budget and preparation of the State General Account (*Conta Geral do Estado*).
- The **Public Treasury Subsystem** which governs the process of financial programming, and the management of disbursements and payments in relation to the State Budget and the State treasury position. The subsystem also deals with the preparation of public financial statistics and the management of internal and external public debt.
- The **State Patrimony Subsystem** governs the coordination and management of the state's assets, the organization of the information regarding the inventory of State assets and preparation of the respective inventory.
- The **Internal Control Subsystem**, which governs the inspection of the correct use of public resources, of the application of accounting rules and methods, and of compliance with legal norms and procedures.

21. The application of the SISTAFE law is regulated by the SISTAFE Regulations. These establish an integrated, harmonized system of norms and procedures for the application of SISTAFE in all state agencies and institutions, respecting the limits of autonomy.

2.3.2 The *Tribunal Administrativo* and the Audit process

22. The *Tribunal Administrativo* (literally translated, the "Administrative Court") is charged with the overall jurisdiction and oversight of public expenditures⁸. This jurisdiction is carried out both through the audit of public accounts and through the *Tribunal's prerogative* of pre-auditing public expenditures, by the granting or withholding of clearance ('*visto*') to engage in actions, contracts or other legal processes which generate public spending commitments. All state agencies and public institutions at central, provincial and local levels are subject to audit and pre-audit by the TA, including financially and administratively autonomous entities, and the municipalities⁹.

23. The *Tribunal Administrativo* is therefore the supreme institution for the control of the legality of administrative acts and the oversight of public expenditure¹⁰ - an autonomous body whose president is nominated by the President of the Republic and approved by the National Assembly. The TA is directly responsible for auditing the individual accounts of government entities as well as the overall *Conta Geral do Estado*. In addition to this auditing function, it has a judicial status, acting as the *Tribunal de Contas* in reviewing and reaching final decisions over the audits of individual departments, as well as imposing fines and/ or initiating criminal investigations, where relevant. Thus, in its capacity as a *Tribunal de*

⁸Art. n.º 1 da Lei n.º 5/92, de 6 de Maio

⁹ Art. n.º 1, 2 e 3 da Lei n.º 13/97, de 10 de Julho

¹⁰ Art. n.º 173 da Constituição da República

Contas, the TA performs most of the functions performed by a Parliamentary Public Accounts Committee in a Westminster-based system. Only the audit of the *CGE* and the related audit opinion (*parecer*) of the TA is submitted to the *Assembleia da República*, where it serves as a basis for the assessment and approval of the public accounts (*CGE*)¹¹.

24. Because the *CGE* is a consolidated financial statement for the whole of central government, the TA's audit of this account cannot address detailed management questions on the use of funds and on procurement processes. Rather it considers its correctness and completeness as a set of consolidated accounts. The more detailed audit of transactions and of the functioning of internal control and procurement systems is undertaken through the ministry by ministry audits.

25. The TA also exercises two major pre-audit functions on a regular basis: the review and approval/ rejection of a) proposals for recruitments into the civil service and b) large-scale tender decisions. Without limitation, all concession, loan, procurement and public works contracts, which generate public expenditure and are executed by the state, are obligatorily subject to pre-audit.

26. Some commentators have argued that these additional 'pre-audit' functions may either draw resources away from the external audit function and/ or generate conflicts of interest. We would disagree with this assertion: these functions are performed by separate departments of the TA by staff who have neither the mandate nor the qualifications to become involved in external audit. There is a separate question over the desirability of having these pre-audit functions (rather than placing decision-making responsibilities exclusively within the relevant executing ministries) but we do not believe this is relevant to the quality of external audit.

2.3.3 Municipalities, provinces and districts

27. Given the geographical extensiveness and cultural diversity of Mozambique, questions related to the geographical deconcentration of responsibilities and their administrative decentralisation (or delegation) have a considerable importance, both politically and for the efficiency of financial management. The Municipal Legislation (*Pacote Autárquico*) of 1997, created 33 urban municipalities with full financial and political autonomy. The law sets out clear criteria for determining the distribution of the two annual transfers that municipalities receive from central government, namely the *Fundo de Compensação Autárquica* (FCA) to cover recurrent expenditure and the *Fundo de Investimento de Iniciativa Local* (FIIL) for investment expenditure. Thus, the municipalities possess their own finances and assets which are managed autonomously. Nevertheless, they are subject to internal audit by the *Inspecção Geral das Finanças* and external audit by the *Tribunal Administrativo*.

28. In addition to the municipalities, there are 11 provinces and 128 districts, which operate as agencies of the central government ministries on a deconcentrated basis. They are collectively referred to as local governments and operate under the local government laws and regulations, although they also fall under the remit of the SISTAFE law. Provincial and district governments (which are appointed rather than elected) have their own budgets, which are submitted for consideration and approval through the State budget subsystem. They are

¹¹ Art. n.º 38 da Lei 15/97, de 10 de Julho

responsible for programming and managing their budget under the supervision of the relevant State agencies.

2.3.4 The roles of the Ministries of Finance and Planning and Development

29. After the 2004 elections, there was some institutional reform among state agencies and departments. Consequently, the Ministry of Plan and Finance, the government institution previously in charge of public finances, was divided. Today the central government institution in charge of public finances is the Ministry of Finance.

30. Therefore, at the central level the Ministry of Finance is the government institution in charge of the coordination and control of SISTAFE. The Ministry is organized in agencies, which include the Finance General Inspection; the National Treasury Directorate; the National Budget Directorate; the Public Accounts Directorate and the National Patrimony Directorate. At the provincial level, the Ministry of Finance is represented in each province by a Provincial Directorate of Finance.

31. The precise role of the (new) Ministry of Planning & Development and the regulations under which it will operate are currently under development. However, the team have been advised that it is intended that the division of functions should respect the need for the integrated operation of the PARPA, the CFMP, the PES and the Budget (OE) as a 'processo único' (single process). These represent the four key tools of medium-term and annual planning and budgeting in Mozambique and have been re-modelled over 2001 – 2004 to operate as an integrated process.

3 ASSESSMENT OF PFM SYSTEMS, PROCESSES AND INSTITUTIONS

32. The PFM Performance Measurement Framework identifies the critical dimensions of performance of an open and orderly PFM system as follows:

- **Credibility of the budget** - The budget is realistic and is implemented as intended;
- **Comprehensiveness and transparency** - The budget and the fiscal risk oversight are comprehensive, and fiscal and budget information is accessible to the public;
- **Policy-based budgeting** - The budget is prepared with due regard to government policy;
- **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds;
- **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes;
- **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow up by the Executive are operating.

33. In addition the measurement framework identifies a set of relevant criteria with regard to donor practices:

- **Donor practices** – external grant and concessional loan financing for government activities is budgeted and disbursed in ways which generate predictability in funding and transparency in the allocation and use of funds, whilst also promoting the use of national systems and procedures.

34. Table 1 overleaf provides a full listing of the 31 indicators on which the assessment is based and a scoring of PFM performance at end 2004 in relation to these indicators. A full description of the methodology which has been followed is available at www.pefa.org. For each of the 31 indicators, this chapter explains how the score has been reached, identifies the PFM reforms and other measures implemented during 2005 likely to impact on the quality of performance and presents a prognosis of the potential situation at end 2006, if reforms continue to be implemented effectively.

35. The Summary Assessment at the beginning of this report provides an overview of the whole assessment and its implications. Summary tables of the 2004 scoring and the potential 2006 scoring are presented in Annexes One and Two, respectively. The potential 2006 scores should be interpreted as an indication of the scale of improvements that might in principle be possible. It would not be appropriate for these potential scores to be interpreted as firm targets, given the optimistic assumptions on which they are based.

Table 1: Summary of PFM Performance Ranking at end 2004

INDICATOR		2004 Scoring
A. PFM-OUT-TURNS: Credibility of the budget		
PI-1	Aggregate expenditure out-turn compared to original approved budget	A
PI-2	Composition of expenditure out-turn compared to original approved budget	B
PI-3	Aggregate revenue out-turn compared to original approved budget	B
PI-4	Stock and monitoring of expenditure payment arrears	D+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI-5	Classification of the budget	B
PI-6	Comprehensiveness of information included in budget documentation	B
PI-7	Extent of unreported government operations	C+
PI-8	Transparency of inter-governmental fiscal operations	C+
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D+
PI-10	Public access to key fiscal information	C
C. BUDGET CYCLE		
C(i) Policy-Based Budgeting		
PI-11	Orderliness and participation in the annual budget process	B
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+
C(ii) Predictability and Control in Budget Execution		
PI-13	Transparency of taxpayer obligations and liabilities	B
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C+
PI-15	Effectiveness in collection of tax payments	D+
PI-16	Predictability in the availability of funds for commitment of expenditures	D+
PI-17	Recording and management of cash balances, debt and guarantees	B+
PI-18	Effectiveness of payroll controls	D+
PI-19	Competition, value for money and controls in procurement	C
PI-20	Effectiveness of internal controls for non-salary expenditure	D+
PI-21	Effectiveness of internal audit	C+
C(iii) Accounting, Recording and Reporting		
PI-22	Timeliness and regularity of accounts reconciliation	B
PI-23	Availability of information on resources received by service delivery units	C
PI-24	Quality and timeliness of in-year budget reports	C+
PI-25	Quality and timeliness of annual financial statements	C+
C(iv) External Scrutiny and Audit		
PI-26	Scope, nature and follow-up of external audit	D+
PI-27	Legislative scrutiny of the annual budget law	B+
PI-28	Legislative scrutiny of external audit reports	C+
D. DONOR PRACTICES		
D-1	Predictability of Direct Budget Support	C+
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D+
D-3	Proportion of aid that is managed by use of national procedures	D

3.1 Budget credibility

36. The indicators included in this group are designed to gauge the extent to which government budgets are implemented as intended, including the extent to which arrears are allowed to build up. They do this by comparing actual revenues and expenditures with budgeted ones, by analysing the deviation in the actual composition of expenditure from the approved budget, and by examining the management of expenditure payment arrears.

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-1	Aggregate expenditure out-turn compared to original approved budget	A
PI-2	Composition of expenditure out-turn compared to original approved budget	B
PI-3	Aggregate revenue out-turn compared to original approved budget	B
PI-4	Stock and monitoring of expenditure payment arrears	D+

37. As far as **aggregate expenditure out-turn** is concerned, the table below summarises the results for the last three complete fiscal years. Figures include recurrent and internally financed investment expenditures but exclude debt service payments and externally-financed investments¹². As can be noted, in two out of the three most recent years, the aggregate out-turn has been within plus or minus 5 % of the approved budget, meriting an “A” score.

	2002			2003			2004		
	Budget	Actual	Out-turn	Budget	Actual	Out-turn	Budget	Actual	Out-turn
10 ⁹ M									
Recurrent Expenditure	13,523	14,077	104.1%	16,858	15,916	94.4%	19,578	19,082	97.5%
Personnel Expenditure	6,198	6,470	104.4%	7,365	7,617	103.4%	9,148	9,410	102.9%
Goods and Services	3,213	3,208	99.8%	4,407	3,364	76.3%	4,578	4,129	90.2%
Transfers	2,699	2,702	100.1%	3,135	2,952	94.2%	3,613	3,497	96.8%
Debt service charges	1,088	1,262	116.0%	1,176	1,355	115.2%	1,228	1,228	100.0%
Capital Expenditure	2,530	2,702	106.8%	3,490	2,534	72.6%	3,414	3,106	91.0%
TOTAL	14,965	15,517	103.7%	19,172	17,095	89.2%	21,764	20,960	96.3%

Source: Government of Mozambique, OE and CGE 2002, 2003 & 2004. Figures are the sum of ‘despesas correntes’ (Mapas V of the OE and 10/28 of the CGE) and internally-financed ‘despesas de investimento’ (Mapas IX of the OE and 16/32 of the CGE).

¹² The exclusion of externally financed expenditures means that these figures are not equivalent to the published data of expenditure by economic classification presented in the CGE, which include both internally and externally financed expenditures.

38. 2002 was an unusual year, in the sense that the Government was still trying to address the effects of the severe floods that hit the country in 2000 and 2001. In order to accommodate some of the additional expenditure required, a supplementary budget was introduced in September 2002. This explains the expenditure over-run recorded when compared with the original budget. However, if the revised budget were to be taken as the starting point, the final out-turn would have been 88.7%, which would have brought down the scoring. According to interviews with senior MF staff, the low final out-turn was due to the fact that the release of funds for expenditures had to be lower than planned due to difficulties in achieving the ambitious revenue targets approved in the Supplementary Budget¹³.

39. Despite the overall improvement in aggregate out-turn, it is interesting to note that the Government consistently over-spends on personnel, and consistently under-spends on goods and services and capital expenditure. The importance of these deviations is compounded by the differences which exist in the **composition of expenditure**. The variance in the composition of expenditure out-turns additional to overall aggregate variance (as measured under PI-1) was 6.7% in 2002, 4.6% in 2003 and 3.9% in 2004. Hence, it exceeded five percentage points in only one of the last three years, giving a “B” score for indicator PI-2. (See data presented in Annex 4.)

40. Nevertheless, an analysis of some of the main administrative units reveals interesting patterns (see Table below)¹⁴. Again looking only at recurrent and internally-financed investment expenditure, over the past three years the Presidency and the Ministry of Foreign Affairs have seen their actual expenditure figures end up well beyond original budgeted estimates. On the other hand, the Ministry of Health has consistently under-spent against approved budgets. The picture is mixed for the Ministries of Planning and Finance and Agriculture, but with large variances that are difficult to interpret. In part, these patterns of under-spending may be explained by the fungibility between budget allocations and off-budget financing. For example, if off-budget external aid resources are procured for an item previously provided for in the budget (such as the purchase of medicines), then a reallocation of budget provisions is likely. It may also be that, in other areas, externally financed project expenditures are lower than expected, with consequent under-spending on project counterpart funds and on related recurrent costs.

10 ⁶ M	2002			2003			2004		
	Budget	Actual	Variance	Budget	Actual	Variance	Budget	Actual	Variance
Presidency	151.7	217.8	43.6%	211.7	262.6	24.0%	265.2	334.9	26.3%
Ministry of Foreign Affairs	109.7	115.4	5.2%	130.1	218.9	68.3%	154.7	222.7	44.0%
Ministry of Planning and Finance	115.6	175.3	51.6%	205.6	154.5	-24.9%	271.6	339.1	24.9%
Ministry of Agriculture*	271.5	297.3	9.5%	393.0	426.0	8.4%	485.8	375.4	-22.7%
Ministry of Health*	1,456.4	1,220.5	-16.2%	1,812.1	1,019.3	-43.8%	1,942.9	1,561.0	-19.7%

* Central and Provincial Expenditure

Source: Government of Mozambique, OE and CGE 2002, 2003 & 2004

¹³ There had been an agreement with the IMF that Treasury releases would be managed in the light of actual rather than planned revenue receipts.

¹⁴ The full dataset for this indicator can be found in Annex 4.

41. **Revenue estimates** are still an area of concern for budget credibility in Mozambique. Over the past three years, aggregate revenue out-turn has been 101.6% for 2002, 94.9% in 2003 and 89.2% in 2004. Thus, it was above 94 % of budgeted domestic revenue in two out of three years meriting a “B” score. Taking into account the 2002 revised budget, the score would have been lower, as final revenue out-turns corresponded to only 87.5% of revised revenue estimates, which is surprising given that the supplementary budget was passed in September, when more accurate projections should have been available. These results point to the need to improve the forecasting of domestic revenues and the management of collections in relation to agreed targets.

42. Finally, concerning **expenditure payment arrears**, there is a significant problem in that there exists no consolidated, central process for recording and accounting for payment arrears. This is in large part linked to the fact that expenditure commitments are not centrally recorded: centralised accounting records cover only advances for expenditure and final payments¹⁵. However, the system of monthly advances to spending agencies (*sistema duo-decimal*) does not allow for a significant build-up of arrears because it places tight credit ceilings on the maximum level of expenditure that can be committed at any one time and it compels spending agencies to reconcile accounts on a monthly basis. Moreover, arrears are in formal terms not permitted – a fact of which government suppliers are well aware, which serves to discourage delivery of goods ‘on credit’ or against commitment orders. Before the introduction of the new SISTAFE legislation, an estimation of uncleared commitments¹⁶ at year end was made so that they could be paid during a specific ‘complementary period’ (*periodo complementar*), corresponding to the first quarter of the following financial year. In 2003, the last year in which such a procedure was applied, the value of payments made in the *periodo complementar* was not significant, at less than 1% of total expenditure. We may take this as a reasonable proxy for the level of arrears at that time. These data are consistent with the view that the *sistema duo-decimal*, combined with the reluctance of suppliers to deliver goods against commitment orders have tended to prevent the build-up of payment arrears. This dimension of the indicator therefore scores an “A”, because we estimate that the stock of arrears remains below 2 % of total expenditure.

43. With the introduction of the new legislation, the *periodo complementar* has been abolished and all payments are now formally required to be cleared during the budget year. In practice, it is inevitable that some expenditure commitments will not be cleared. Sector ministry staff advised us that this is indeed the case and that this small level of arrears is simply cleared from the subsequent year’s budget allocation, despite the fact that there is no formal provision. Donor agencies also reported significant levels of arrears in the payment of counterpart funds for externally financed projects¹⁷. At the moment, it is not possible to clearly identify expenditure payment arrears either in the budget or in the annual accounts.

¹⁵ We were however informed that expenditure commitments are recorded at line ministry and provincial levels, where the *compromiso de despesa* process represents the first step in the expenditure chain.

¹⁶ Uncleared commitments do not become payment arrears until the corresponding goods or services have been delivered and the due date for payment for such deliveries has been passed. Nevertheless, the size of the “float” of uncleared commitments at year end gives an indication of the underlying stock of arrears.

¹⁷ These are normally calculated on the basis of the estimated tax receipts by Government on goods imported by the project. They thus have a direct revenue counterpart but nevertheless need to be paid.

Whilst there is no reason to suspect a big build-up of unrecorded payment arrears, the lack of transparency in their recording and management leads to a low overall score on this indicator.

Developments in 2005 and prognosis for 2006

44. Looking at potential trends over the near future, 2005 is an anomaly, given that the holding of the general elections in December 2004 shifted the budget calendar to allow time for the new Government to take power. The 2005 Budget was only approved in May 2005, leaving the first four months of the year operating under bridging arrangements, using 2004 allocations. Aggregate results for the first semester of 2005 are not particularly encouraging from the point of view of budget credibility, as the overall mid-year out-turns as a percentage of the approved budget represents 40.1% for revenues, 40.6% for recurrent expenditure and only 26.8% for investment expenditure. (See Table below.) Although both revenue collections and expenditures are generally higher in the second half of the year, deviations from the approved budget in excess of 5 % should certainly be expected. In this event, the score on the indicator of aggregate out-turns (PI-1) would fall from “A” to “B” and the indicator of revenue out-turns (PI-3) might also fall.

	10 ⁹ Mt	2005		
		Budget	Actual	Out-turn
Revenues		22,226	8,906	40.1%
Recurrent Expenditure		22,464	9,118	40.6%
Personnel Expenditure		11,045	5,134	46.5%
Goods and Services		5,308	1,966	37.0%
Transfers		4,003	1,796	44.9%
Investment Expenditure		19,001	5,097	26.8%
Total		41,465	14,215	34.3%

Source: Government of Mozambique, OE 2005 and BERs for 1st and 2nd Quarters, 2005.

45. Ongoing reform efforts are likely to influence overall budget credibility in a number of ways, especially in relation to tax administration and revenue generation (see indicators PI - 13, 14, and 15). It is difficult, however, to predict how the results of this assessment may change between now and 2006, especially given the anomalies registered during 2005.

46. With regard to the recording of expenditure arrears, we understand that once fully operational, the SISTAFE system will provide for a systematic recording of commitments (as well as payments) across central government (including spending at provincial levels). It will thus provide for the accounting information necessary to track the level of payment arrears. However, the system will not be fully operational across central government until 2007 or 2008. Moreover, the precise stage in the expenditure chain at which commitments are recorded is important in exerting effective control over commitments before they are made (rather than simply recording them after the event). We were unable to clarify the precise nature of the commitment control process anticipated under e-SISTAFE.

47. In the short-term, an explicit exercise to assess current arrears on counterpart funds for externally funded projects would be useful in accelerating the rate of execution of the Development Budget. It would also serve to improve performance against this indicator.

3.2 Transparency and comprehensiveness

48. This set of indicators assesses whether the information that the Government generates is consistent, understandable, comprehensive and accessible across a number of dimensions. These include information on operations that may fall outside normal fiscal reporting procedures, relationships with local governments and other autonomous bodies, and issues of fiscal risk oversight.

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-5	Classification of the budget	B
PI-6	Comprehensiveness of information included in budget documentation	B
PI-7	Extent of unreported government operations	C+
PI-8	Transparency of inter-governmental fiscal operations	C+
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D+
PI-10	Public access to key fiscal information	C

49. The new system of **budget classification** introduced in 2003 uses the standard COFOG functional classifiers. These have enhanced the Government’s capacity to report on budget allocation and execution, above and beyond the existing classification based on economic and administrative classifications. However, in the budget documentation, the functional classification is only presented for the 10 main COFOG functions¹⁸, leading to a “B” rather than an “A” score for this indicator. In the *Conta Geral do Estado*, a full breakdown by function and sub-function is provided, but with some inconsistencies which derive from the fact that it is not the executing agencies themselves but the DNCP, who determine (on an ex-post basis) the attribution of expenditure to sub-functional classifiers. The introduction of SISTAFE will necessitate an improvement in the consistency of budget classification, with sub-functional classifications consistently applied in both budget and accounting records. It will not however be possible to have this in place before the 2007 budget.

50. The information included in the 2005 **budget documentation**, as submitted to the *Assembleia da República*, includes five out of the nine required elements of information, as specified in the PEFA methodology:

¹⁸ The UN-supported Classification of the Functions of Government (COFOG) allows for a functional classification which cuts across administrative entities. It includes 10 main functions at the highest level and 69 sub-functions at the second level. An “A” score would require consistent use of both functional and sub-functional classifiers.

ELEMENT	PRESENCE
1. Macro-economic assumptions , including at least estimates of aggregate growth, inflation and exchange rate	Yes
2. Fiscal deficit , defined according to GFS or other internationally recognized standard	No
3. Deficit financing , describing anticipated composition	No
4. Debt stock , including details at least for the beginning of the current year	No
5. Financial Assets , including details at least for the beginning of the current year	No
6. Prior year's budget outturn , presented in the same format as the budget proposal	Yes
7. Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal	Yes
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year	Yes
9. Explanation of budget implications of new policy initiatives , with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	Yes

51. Information about the fiscal deficit is present in the budget documentation, but not in a format that complies with international standards. Thus, it would be possible to calculate the fiscal deficit from the information available but it is not explicitly presented in GFS format. Much of the relevant information is also limited to the background document to the budget (*Documento de Fundamentação do Orçamento*), and is not reflected in the tables which are then published by the Government Press (*Imprensa Nacional*). In particular, these do not include data on prior year's outturn and current year estimates, which might be directly compared with the newly approved budget allocations. There are no immediate reform plans to address this issue, but this is an area where very specific actions by the Government could lead to an immediate improvement in the score for this indicator.

52. The comprehensiveness of the budget can be significantly undermined by the existence of **unreported government operations**. A major study of this issue was conducted over late 1999 and early 2000 and reported in Austral 2000. This revealed significant levels of off-budget spending financed both through 'own revenues' (*receitas próprias*) and through externally financed projects. This led to a plan of action to reduce levels of off-budget spending. Actions with regard to externally-financed projects were later taken up in the context of the harmonisation and alignment agenda and are reported below with reference to indicators D-2 and D-3. In relation to off-budget expenditure financed through *receitas próprias*, actions related to the rationalization of the fees and charges which could be levied directly by line ministries, and increased efforts to record expected collections in the budget. An analysis of budget documentation over 2001 – 2004 suggests that these actions have been

resolutely pursued and have had some success. Nevertheless, there has not been a recent comprehensive assessment of off-budget spending from *receitas propias*, by which progress could be rigorously judged¹⁹. A study of off-budget spending in the health sector was however completed in early 2005. Based upon this study and the Austral 2000 report, we would judge that the magnitude of these expenditures is above 1 % but below 5 % of total expenditures, giving a “B” score, on this dimension of the indicator.

53. There is no doubt that externally financed project expenditures constitute the bulk of unreported government operations. Whilst efforts to improve recording are being made, most donor agencies providing grant finance have proven reluctant to channel their project expenditures through the Government’s disbursement systems. They thus preserve separate banking arrangements and, as a result typically employ separate budgeting and accounting procedures. In order to be “on-budget”, it is necessary both for anticipated expenditures to be reported and approved through the OE and for actual expenditures to be recorded in final accounts (the *CGE*) and, ideally, in quarterly Budget Execution Reports. Procedures are now being established for externally financed projects to manage disbursements through the Treasury Single Account (*Conta Única do Tesouro, CUT*). This will require prior approval of spending through the OE and will automatically generate an accounting record. However, the CUT has only been in operation since 2004 and the full set of disbursement and accounting procedures associated with the CUT can only be effective, when e-SISTAFE is fully operational. Until such time, the recording of externally financed project expenditures must rely on special reporting processes outside of the normal accounting system. This has proven very difficult to introduce as a standardised routine for all donor agencies. Therefore, to date, comprehensive reporting exists only for loan-financed projects, where disbursements are recorded in the DNT’s CS-DRMS debt system²⁰, which has been installed with support from the Commonwealth Secretariat. This leads to a “C” score on this dimension and an overall score of “C+” for the indicator.

54. **Inter-governmental fiscal relations** in Mozambique are based on the Municipal Legislation (*Pacote Autárquico*) of 1997, which created 33 urban municipalities with full financial and political autonomy. The law sets out clear criteria for determining the distribution of the two annual transfers that municipalities receive from central government, namely the *Fundo de Compensação Autárquica* (FCA) to cover recurrent expenditure and the *Fundo de Investimento de Iniciativa Local* (FIIL) for investment expenditure. It also indicates that overall transfers should reach 1.5-3% of domestic revenue. Distribution of transfers should be based on four criteria: population, area, revenue collection, and degree of economic development. In this sense, the system is transparent and rules-based. Accordingly, an “A” score has been attributed to this dimension of the indicator.

55. The main drawback is that central government has yet to develop the necessary informational base to apply the full set of criteria, and until today has only utilised the population criterion to determine annual transfers. Although this may still be described as a

¹⁹ The 1999-2000 study was itself selective in its choice of ministries and did not make estimates for the whole of government.

²⁰ It should be noted that even in the case of loan financed expenditures, although the level of disbursements by project is carefully tracked, it is not possible to match the expenditure breakdown to the expenditure classifiers employed for the OE and CGE.

transparent and rules-based system, it can hardly be defined as fair. For example, municipalities with small populations and large areas are at the moment losing out in favour of others with larger populations but smaller areas, which also tend to be the municipalities with higher revenue collections. Moreover, there is not yet a transparent plan for moving to the application of the full set of criteria.

56. Information regarding transfer levels for the forthcoming budget year at the moment officially only reaches municipalities after the national budget has been approved by Parliament, which does not leave sufficient time for budget amendments at municipal level to be made before the start of the fiscal year. Thus the “C” score for this dimension of the indicator. Given the rules-based system on which they rely and the fact that allocations can consequently be pre-calculated prior to their approval by the *Assembleia da República*, indicative allocations should and could be communicated to municipalities with much more promptness by central government, for example when budget ceilings are communicated to the sectors, in May of each year.

57. Finally, given their full financial autonomy, municipalities report directly only to the local assembly. Financial reports are sent for information to the Ministry of Finance, and for audit purposes to the Tribunal Administrativo. However, these are often late and incomplete. The Ministry of Finance compiles them in summary form in the *Conta Geral do Estado*, but only with general revenue and expenditure categories, which makes consolidation according to sectoral categories virtually impossible. The low score for this last dimension leads to an overall “C” score for the indicator as a whole.

58. A revision of the legislation regarding municipal finances to correct some of the problems identified above has been planned for some time, but progress has been quite slow. The National Association of Municipalities has made it a priority to pursue further dialogue on this with central government, but no imminent changes are expected. The present score for this indicator is not likely to substantially change over the next couple of years, apart from an improvement that could come from more timely information sent by central government to municipalities regarding their allocations for the coming year.

59. In terms of its **oversight of aggregate fiscal risks**, central government needs to monitor the performance of sub-national governments as well as autonomous government agencies, public enterprises and private enterprises where the government has a significant shareholding. The performance of public enterprises is monitored directly by the Treasury (DNT) who receive quarterly financial reports as well as fully audited annual accounts. DNT scrutinise these reports and provide corresponding briefings to the Minister of Finance on an enterprise by enterprise basis. They are also empowered to direct IGF to undertake internal audit investigations where necessary. However, to date there is no consolidated assessment of fiscal risk across all public enterprises.

60. IGEPE has responsibility for monitoring public investments in private companies. Most of these constitute former public enterprises, which have been identified for restructuring or privatisation. In some cases, private shareholders have bought equity in these enterprises, following a restructuring process; in others, operations have been closed and assets put up for sale. A number of these companies are experiencing performance problems and thus represent a significant source of contingent liabilities for government. Budget provision is currently made in cases where these have become actual liabilities – for example, where the salaries of current staff or the pensions of former staff can no longer be met by these

companies. However, IGEPE does not yet have a procedure for making a consolidated risk analysis of all the companies under its remit nor for making budget provision for *contingent* (rather than actual) liabilities. Moreover, there is not yet a routine procedure for consolidating fiscal risks from public enterprises with the fiscal risks emerging from state investments monitored by IGEPE. Overall, then, this dimension of the indicator scores a “C”.

61. In terms of sub-national governments, namely municipalities, legislation does not permit borrowing or the incurrence of debt. However, municipalities can still incur liabilities to staff or to suppliers and, at present, there is no system for monitoring of their fiscal position. Where problems have occurred in the past, these have been dealt with *ex post* in an ad hoc manner. This is not consistent with a comprehensive oversight of fiscal risk and could present significant problems in the future, as the scope of municipal activities continues to expand. This dimension of the indicator thus scores a “D”, giving an overall score of “D+”.

62. **Public access to key budget information** happens through a number of channels. The Government publishes some of the relevant documentation through the *Imprensa Nacional*, and/or makes it available through the Public Information Bureau (*Bureau de Informação Pública*). Increasingly, information is also made available through the internet. The Ministry of Finance, the Central Bank, the *Tribunal Administrativo* and other government institutions all have websites where relevant information is made available, albeit with different degrees of completeness and promptness. The present score is quite low principally as a consequence of the lack of a proactive policy of dissemination, which means that the information that is made available to the public is either made available with considerable delays, or in forms that are not easy to understand and interpret without sophisticated technical skills and knowledge of budget issues and processes. For example, budget documentation is only made available publicly after Parliament’s approval. Budget execution reports and year-end financial statements are made available within an acceptable timeframe, but in a format which is not very user-friendly. External audit reports are put on TA’s website with some delay, while information on public contract awards, and on resources made available to service delivery units is not yet available anywhere.

Institution	Website	Information available
<i>Direcção Nacional de Plano e Orçamento</i>	www.dnpo.gov.mz	Budget laws and documents, internal regulations and circulars, policy documents, legislation
<i>Tribunal Administrativo</i>	www.ta.gov.mz	Audit reports on Government Accounts
<i>Banco de Moçambique</i>	www.bancomoc.mz	Markets, statistics, information

Developments during 2005 and prognosis for 2006

63. Overall, it would appear that transparency of budget and expenditure information is an area where progress could be made in a reasonably short period of time, simply by committing to providing better and more timely information, and undertaking the relatively simple steps necessary to achieve this. This will crucially depend on the priority given by the Government to transparency and inclusion, with a view to ensuring that non-state actors which have historically been excluded from policy dialogue have more opportunities to access recent and relevant budget information. Our judgement is that this is an omission

rather than a deliberate policy. Even in OECD countries, it is only relatively recently that attention has been given to the importance of transparent public finance information, readily accessible to the Legislature, to sub-national governments and to civil society.

64. As we have noted above, the information necessary to develop a consolidated fiscal risk analysis is largely available. The issue here is simply one of developing the necessary techniques and routines for a six-monthly or annual consolidated report by IGEPE and DNT. Thus, in relation to public enterprises and companies with public shareholdings, it ought to be possible to make good progress over 2006. In relation to municipalities, there is an institutional issue to be addressed, in that the central government's rights for information from municipalities relate only to the budget and to the *conta de gerencia*, which may not be sufficient to identify contingent liabilities. Moreover, oversight responsibilities rest by default with DNO but are not formalised. So long as controls over municipal borrowing remain in place, the level of risk arising from the lack of clear oversight is limited but it seems unlikely that this issue can be addressed during 2006, whereas the municipalities are lobbying increasingly actively for borrowing rights.

65. With regard to the comprehensiveness of budget coverage, the high level of externally financed project expenditures which remain off-budget represents a significant problem, with repercussions for the quality of budgeting, of treasury management and expenditure reporting. However, the significance of this issue has been comprehensively highlighted – most recently in the Paris Declaration on Aid Effectiveness of March, 2005. A Government-Donor Task Force on off-budget spending has been established and progress is being made, on which we report more fully, in section 3.7, with regard to Donor Practices.

3.3 Policy-based budgeting

66. This section assesses the extent to which budgets reflect stated government policies. It considers both process issues (relationship between Ministry of Finance and other agencies, degree of political involvement and parliamentary approval), and actual content (links between annual budgets and multi-year plans and policies). It considers the budget preparation process for the 2003, 2004 and 2005 fiscal years.

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-11	Orderliness and participation in the annual budget process	B
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+

67. Especially with the introduction of the SISTAFE legislation in 2003, the Mozambican budget now conforms to an established **annual budget process**. This starts in May with the budget circular sent by the Ministry of Finance, giving government agencies budget ceilings and instructions for preparing budget estimates. By end-July, agencies need to submit detailed budget proposals, which are then aggregated by the Ministry of Finance and submitted to Cabinet by mid-September, and to the *Assembleia da República* by the end of September. The *Assembleia* then has to approve the budget before the end of the year, for implementation to start on 1st January. Despite occasional delays (e.g. for the 2005 budget,

delayed due to the general elections held in December 2004), this calendar is generally respected, and allows government agencies sufficient time to prepare budget proposals.

68. The calendar does not however allow for systematic and significant political involvement in the early stages of budget formulation. In particular, Cabinet does not analyse and approve the Medium-Term Fiscal Framework (*Cenário Fiscal de Medio Prazo*, CFMP), which sets out the main macroeconomic forecasts and determines the overall resource envelope and sectoral budget ceilings. This prevents meaningful engagement at Ministerial level in discussions regarding overall fiscal policy and strategy. Cabinet only approves the budget after agencies have formulated detailed proposals, which seriously constrains its ability to make adjustments and actively participate in the definition of budget priorities.

69. Parliamentary scrutiny has been reasonably punctual in analysing and approving budgets before the start of the fiscal year (again except for 2005). The fact that approval only comes at the end of December has caused some inconvenience, given the fact that promulgation and publication of the budget legislation is usually delayed until January, once the fiscal year has already started. Nevertheless, it is the five month delay in the approval of the 2005 budget, which has reduced the scoring against this dimension of the indicator. Given the information above, the overall score for indicator PI-11 is “B”.

70. The SISTAFE Law has institutionalised the **CFMP as a fundamental planning instrument in budget formulation**. The CFMP is prepared every year by the Ministry of Finance, including forward estimates of fiscal aggregates and an indication of the functional allocations to the priority sectors. While it is a useful instrument for determining overall budget policy on the basis of a multi-year framework, the CFMP is mostly seen as an exercise internal to the Ministry of Finance, and not as a policy instrument for constructive dialogue with other agencies and with the political level. Indeed, the involvement of sector ministries in the preparation of expenditure projections is very limited and the consequent link to sector strategies is tenuous.

71. The quality of the forecasts also needs to be questioned. While, as could be expected, there is a reasonable correspondence between aggregates in the CFMP and in the budget (OE) for the same year, there are significant discrepancies between forward estimates and budget figures for the following year, as exemplified in the table below. At the aggregate level, these discrepancies derive predominantly from differences between the OE and the CFMP in the coverage of externally financed projects and in the underlying inflation assumptions. At the sector by sector level, the discrepancies are still greater, reflecting the fact that the main vehicle for prioritisation of allocations is the annual budget process rather than the CFMP. In short, the CFMP exists as a tool of medium term planning but is not yet effectively utilised for its intended purpose. The weak links between the CFMP and the annual budget result in a “C” score for this dimension of the indicator.

	Total Revenue		Total Expenditure	
	2004	2005	2004	2005
10 ⁹ Mt				
CFMP 2004-8 forecasts	17,456.0	20,526.3	34,485.6	38,330.1
OE 2004 budgeted	17,810.5		33,602.3	
OE 2005 budgeted		22,225.9		46,783.4

Source: Government of Mozambique, OE 2004 & 2005 and CFMP 2004-08.

72. Since the accession of Mozambique to HIPC relief, annual debt sustainability analyses for both internal and external debt have been undertaken jointly by the Ministry of Finance and the IMF in the context of the Article IV discussions, meriting an “A” score for this dimension of the indicator. A debt management strategy has now been prepared, with support from Debt Relief International, and it is scheduled to be approved by Cabinet and Parliament before the close of 2005. There is an associated capacity building programme and from 2006, annual debt sustainability analyses are expected to be undertaken directly by DNT.

73. Consistent forward-looking estimates and multi-year perspectives are more difficult to find at the sectoral level. Most of the main sectors in Mozambique have developed sectoral strategic plans that define objectives and policies for a medium- to long-term horizon of 5 to 10 years. However, these strategic plans are not fully costed in terms of the recurrent and capital financing implications of the indicated policies. More often they provide statements of desirable scenarios which are not resource-constrained, and are used more for fund-raising than for policy-making purposes. While some sectors are more advanced in this respect than others, substantial qualitative improvements in these processes will be needed, if the score for this dimension is to rise above the “C” it currently merits.

74. The poor link between long-term strategies, medium-term policies and annual budgets is also reflected in the overall lack of investment plans that prioritise interventions according to resource availability and recurrent cost implications. In part, this lack of an adequate long-term perspective might be due to the heavy influence of donor funding in many of the main sectors. Fragmented and piecemeal donor funding inevitably undermines serious planning and forecasting. Sector-Wide Approaches, now under way in a number of sectors, are trying to address this issue by promoting more coordinated interventions based on a common policy framework jointly negotiated with the Government. Thus, there is a link between budgeting for investment and recurrent spending, meriting a “C” score rather than a “D” score for this dimension. However, such initiatives have not yet had a noticeable impact on the quality of planning for recurrent costs of investment decisions.

Development during 2005 and prognosis for 2006

75. Current budgetary reforms do not directly touch on the issue of Cabinet engagement in the definition of the CFMP and the budgetary ceilings. However, through a process of sensitisation on the importance of this issue and a subsequent change to the calendar, there is no reason why Cabinet approval of the CFMP/ budget framework should not be made standard practice from 2006 onwards.

76. On the question of timely approval of the budget in election years, the significance of delays in budget approval does not appear to have been well understood at the political level, in terms of its disruptive effect on service delivery and other government operations. Again, with adequate sensitisation at the political level, it may be possible to make progress but this must be seen as a priority not just for the Executive but for the Legislature (and hence for opposition parties) as well. We would recommend that serious attention should be given to altering the timing of elections so that they occur in March or early April, permitting a new Executive to be in place from May so as to guide the preparation of the new CFMP and budget.

77. Ongoing reforms do not adequately address the problems of medium-term planning and strategic priority setting. The FoPOS project, led by the former DNPO, has been successful in identifying the problems and possible solutions but initiatives at the sector ministry level are not yet integrated within a unified, national vision of a medium term planning process. The future score for this indicator will depend on the evolving nature of the relationship between the Ministries of Finance and Planning, the sector ministries and the donors, and the respective efforts of each in promoting a more consistent forward-looking approach to defining overall resource envelopes and strategic investment choices. Substantial capacity development will be needed before improved performance can be achieved.

3.4 Predictability and control in budget execution

78. This section assesses the extent to which the budget is implemented in an orderly and predictable manner, with adequate arrangements for the exercise of control and stewardship in the use of public funds. It is sub-divided into sections on revenue collection & management, cash management and payroll, procurement & internal controls. The section on revenue collection and management covers both customs duties and direct and indirect taxes.

3.4.1 Revenue collection and management

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-13	Transparency of Taxpayer Obligations and Liabilities	B
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C+
PI-15	Effectiveness in collection of tax payments	D +

79. **The transparency of taxpayer obligations and liabilities** is ensured by the existence of legislation and procedures for major taxes (VAT, IRS, and IRC), which allocate only fairly limited discretionary powers to the government entities involved, meriting a “B” score on this sub-dimension²¹. Tax payers have easy access to information on tax liabilities and administrative procedures (“A” score on this sub-dimension). The information is user friendly and up-to-date and the *Repartições de Finanças* play an active role in taxpayer education and information. In addition, taxpayers can use the *Lojas de Contribuinte* and their local *Repartição de Finanças* for more information on legislation and procedures. A tax appeals mechanism has been established but needs redesign to be fair, more transparent and effective. More public information on the nature of the appeals mechanism would also be desirable. It is the relative lack of transparency and accessibility of information on the appeals process which reduces the overall score to a “B”.

²¹ If stricter limitations on the discretionary powers of the government entities involved could be established, there would be an “A” score against this sub-dimension, rather than a “B” as at present. Current legislative reforms aim to fully clarify roles and responsibilities and place stricter limits on discretionary powers.

80. **Taxpayer registration** is managed through a database for individual and corporate taxes. However, this is not yet fully and consistently linked to other databases in the tax system. The NUIT: *Número Único de Identificação Fiscal* is used in other government databases (namely registration/licensing functions) as the reference number but, in general, linkages to other government systems and financial sector regulatory processes are weak. **Tax assessment** is supported by a system of penalties for non-compliance. Although penalties exist for most relevant taxes, they are not totally efficient due to their limited application. The problem appears to be that the current sanctions regime is too rigid, so that penalties are out of proportion to the sums involved in non-compliance. As such, taxpayers actively avoid paying their penalties and even tax officials can be reluctant to apply them. Tax audits and fraud investigations are undertaken on an ad hoc basis but there is not a continuous and programmed plan based on clear risk assessments.

81. **Effectiveness in collection of tax payments** has been assessed by reference to the level of arrears on tax collections, the banking arrangements for tax payments and the methods of reconciliation of tax assessments, collections and arrears. Over the last two years, the average debt collection ratio for gross arrears (being the percentage of tax arrears at the beginning of a fiscal year which was collected during that fiscal year) has been significantly below 60%, leading to a “D” score on this dimension and hence only a “D+” for the indicator as a whole. The total amount of tax arrears appears to be significant. However, those detailed in the *Conta Geral do Estado (Mapa 04d)* for 2004 include arrears from 2003, many of which comprise arrears for taxes which no longer exist or where the stated period of validity of tax liabilities has been exceeded. DNIA has approved a Circular (05/DNIA/05) where clear instructions have been given to *Repartições de Finanças* to settle these arrears either through annulments of the amounts or through “*juízo em falha*”²².

82. The transfer of tax collections to the Treasury by the revenue administration has generally been made weekly or more frequently if the total amount collected dictated it. The direct method of transfer by the Revenue Administration to the Treasury was abandoned due to reconciliation and classification problems and a new rule of twice weekly transfers is being implemented. This merits a “B” score against this dimension. SISTAFE should permit a shift to direct payments by taxpayers into the Treasury account (meriting an “A” score) but this seems unlikely before 2007 or 2008²³.

83. A complete reconciliation of tax collections and transfers to the Treasury takes place every week and is discussed with the Ministry of Finance on a weekly basis. We understand that a complete reconciliation of assessments, payments, transfers to the Treasury and outstanding arrears is undertaken quarterly, within six weeks of the end of the quarter, meriting a “B” score on this dimension.

²² The relevant procedures are explained in Article 251° and the subsequent articles of the *Código de Execuções Fiscais*.

²³ On the other hand, it should be noted that Maputo generates 85% of national revenue collections so, by 2007, it may be possible to move the majority of taxpayers to a system of direct payments to the CUT.

Developments during 2005 and prognosis for end 2006

84. There is an ongoing programme of tax reform led by the URTI unit. Under this process revisions to the *Lei de Bases do Sistema Tributário* will be completed during 2006. These revisions focus in particular on the development of a fair and functional tax appeals system which will be implemented through independent institutional structures - the *Tribunais Fiscais* due to be established in June 2006. Combined with the current drive to improve the quality and availability of information to the public on tax obligations and liabilities, this should serve to improve the performance on the transparency of obligations indicator.

85. Improvements in the NUIT data-base are planned, in particular focusing on more cross-referencing with other government data-bases (such as that of the Ministry of Industry & Commerce for Business Licensing.) Consideration is also being given to opening new *Lojas De Contribuintes* in cities other than Maputo. However, the most significant improvements in the registration of tax payers relate to the review of the penalties regime and the strengthening of the mechanisms for planning (and targeting) tax audits. If substantial improvements can be made in these areas during 2006, then the score against this indicator will also rise.

86. Improving effectiveness in the collection of tax payments will depend crucially on steps to identify and clear those outstanding tax arrears which remain valid. The instructions issued by DNIA (Circular 05/DNIA/05) to the *Repartições de Finanças* provide for a clear set of actions by which to achieve this but there remain question marks over whether there exists the capacity to undertake such instructions promptly and efficiently. The team therefore anticipates only a modest improvement in this area by end of 2006.

3.4.2 Cash management

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-16	Predictability in the availability of funds for commitment of expenditures	D+
PI-17	Recording and management of cash balances, debt and guarantees	B+

87. **Predictability in the availability of funds** has been assessed with reference to the procedures for cash flow forecasting and management, the mechanisms for the management of within-year treasury ceilings on expenditure and the frequency and transparency of adjustments to budget allocations made by the Ministry of Finance. Cash flows forecasts are prepared for the fiscal year and updated and monitored every week by the Treasury on the basis of actual cash inflows and outflows, meriting an “A” score against this dimension of the indicator. Nevertheless, information about the flow of investment expenditure is still weak, which in part explains the phenomenon of arrears on counterpart fund payments.

88. Information to budget entities on ceilings for expenditure commitment is provided two months in advance according to the *duodecimal* method of budget transfers currently in place. Ideally, treasury management should be based on a quarterly or six-monthly planning

perspective. In addition, the current system is primarily focused on spending against the recurrent budget and does not provide information on counterpart fund payments for donor-financed projects or on the donor flows themselves.

89. Up to the end of 2004, significant in-year budget adjustments decided above the level of management of MDAs were frequent and not done in a transparent manner, i.e., they were made without the knowledge and involvement of the MDAs. It is the poor score against this dimension of the indicator which brings the overall score down to a “D+”. Part of the problem appears to arise from a lack of clarity over the precise procedures for making budget adjustments during the current transition period to the full application of the SISTAFE law. Until 2004 any changes to the budget needed to be supported by an administrative process but this was abandoned in 2005.

90. Performance with regard to the **recording and management of cash balances, debt and guarantees** has been stronger. The quality of debt data recording and reporting is high. External debt records are complete, updated and reconciled on a monthly basis through the CS-DRMS system. Domestic debt records are kept separately. A monthly reconciliation is carried out with data considered of high integrity and a comprehensive management report, including statistics on debt service, stock and operations, is produced annually. (If it were produced quarterly, there would be an “A” score against this dimension of the indicator.)

91. Most of government’s cash balances are calculated and consolidated weekly, but there are still substantial off budget funds remaining outside this arrangement. The single Treasury account (CUT) is reconciled daily through the e-Sistafe and the Central Bank’s STF (*Sistema de Transferencias Financeiras*). The STF is the BdM’s system of recording the financial transactions taking place between the commercial banks and with the Government. It is not an on-line system but it is reconciled daily in a manner which is co-ordinated with DNT to permit daily reconciliation of the CUT. DNT plan to manage this process directly from 2006, using e-Sistafe to make credits directly to commercial bank accounts, without having to use the Central Bank as an intermediary.

92. The systems for contracting of loans and issuance of guarantees is clear and managed within defined limits for total debt and total guarantees. The Ministry of Finance is the sole government entity responsible for approving loans or guarantees²⁴. A new debt strategy has been developed during 2005 and is expected to be approved by the end of the year.

Developments during 2005 and prognosis for end 2006

93. As noted above, much progress has been made in recent years in strengthening cash-flow management and debt management. With the new debt strategy and the related process of capacity building, it should be possible during 2006 to start issuing comprehensive quarterly (rather than annual) reports on debt. Similarly with the implementation of e-SISTAFE, bank reconciliation processes are becoming simpler and faster. However, there remain three problematic areas which are not directly addressed by these reform efforts:

²⁴ As we noted above, the municipalities are pressing to have the right to borrow directly. In terms of debt management and fiscal oversight, this would clearly be unadvisable.

- The extent of within-year adjustments to budget allocations across ministries must be reduced and made more transparent. In part this will require improvements to budget preparation and scrutiny processes so as to increase the realism of the budgets presented to the *Assembleia* for approval. It will also require a more formalized set of procedures for managing and reporting budget re-allocations. In this respect, it may be helpful to limit such re-allocations to quarterly adjustments, made only within three pre-defined periods of the year in the light of quarterly budget execution reports.
- The coverage of cash-flow forecasting processes needs to be extended to include investment expenditures. These should cover at the very least the internally financed component but should ideally also include external finance for projects. Given that the timing of counterpart fund disbursements should be linked to the flow of external finance for projects, these requirements can be simultaneously addressed. Essentially what is needed is a reliable system for line ministries to advise DNT of the cash-flow forecasts for projects and for DNT to confirm the level and timing of internal funds which ministries should expect.
- The coverage of the CUT needs to continue to be expanded so as to reduce the level of off-budget project funding.

94. Work within these areas is ongoing but involves a much wider range of actors than do actions on debt or on bank reconciliation processes. If significant progress is to be achieved during 2006, it will be necessary for Government to find an effective method to co-ordinate and target actions in these areas.

3.4.3 Payroll, Procurement and Internal Controls

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-18	Effectiveness of payroll controls	D+
PI-19	Competition, value for money and controls in procurement	C
PI-20	Effectiveness of internal controls for non-salary expenditure	D+
PI-21	Effectiveness of internal audit	C+

95. The **effectiveness of payroll controls** is significantly undermined by lack of a complete and integrated link between personnel records, the personnel database and the payroll. There are currently three different systems coexisting, which are not regularly reconciled: the *Sistema Integrado do Pessoal* in MAE (for personnel records), the various payrolls run by CPD and the personnel establishment system used by TA in the approval of civil service recruitment. The *Sistema Integrado do Pessoal* is not currently up to date, so there is therefore no effective basis for the independent verification of the payroll. Moreover, there are 12 separate payrolls²⁵ at the national level which are not integrated.

²⁵ There is one covering the Ministry of Defence, one main one which includes all other central government institutions plus Maputo province, then there are separate payrolls for each of the other provinces.

96. Delays in processing changes to personnel records and the payroll are often significantly longer than three months and require widespread retroactive adjustments. CPD has the capacity to do changes on a monthly basis but depends on the responsible line ministries and institutions to provide information on changes correctly and on a timely basis. Internal controls of changes to personnel records and the payroll exist but are not adequate to ensure full integrity of data. DNCP receives each month the payroll print-out from each state institution and based on the previous month's payroll they run a manual check to detect any inconsistency. DNCP is then responsible for forwarding payroll documentation to CPD.

97. Partial payroll verifications to identify control weaknesses and/or ghost workers have been carried out by CPD within the last three years. However, there is no annual systematic plan for the performance of these audits. IGF includes payroll verifications and audit within its mandate and has undertaken payroll audits in a number of institutions. Unfortunately, information about the follow up to these internal audits was unavailable. Personnel costs represent a high and growing percentage of budgeted expenditures (41.7 % of internally financed expenditure in 2002, 44.9% in 2004) so the seriousness of these weaknesses in payroll control systems cannot be overstated.

98. With regard to **procurement**, the data available in the DNPE Activity Plan/ *Balanço Annual* showed that less than 50% of contracts above the national threshold for small purchases are awarded on an open competitive basis. There are question marks over the accuracy of these data but they do appear to correspond to what are known to be common practices in procurement processes. Although regulatory requirements establish that open competition should be the preferred method of competition, State institutions often use other methods of procurement established by the existing legal framework. It is frequently argued that the list of official suppliers does not present sufficient options to meet requirements and/or that the technical specification of goods to acquire is so high that open competition is impractical. In short, the justifications for the current frequent use of less competitive procurement methods are weak, missing or not clear. There is a procurement complaints mechanism in place and the process for submitting and addressing procurement complaints also exists but it is designed very poorly and does not operate in a manner to promote transparency, confidence and timely resolution of complaints.

99. **Internal controls for non-salary expenditure** are generally weak. This is largely because expenditure commitment controls are lacking at central level. Budget entities have a set of procedures to record expenditure commitments but there is no requirement to report commitments to the central level and hence they are not reflected either in accounts or in budget execution reports. There is also widespread anecdotal evidence that commitment controls are not systematically applied even within budget entities. DNCP issues a Circular to all state institutions at the end of the fiscal year requesting information about expenditure commitments not paid (*despesa liquidada e não paga*) for the year ending. However, since the elimination of the *periodo complementar*, there is no separate budget line for clearing arrears and these are simply paid on an ad hoc basis from the new budget allocation. (See PI-4). As we noted above, it is the unwillingness of suppliers to provide goods or services against commitment orders which serve as the most effective control on unpaid commitments, rather than the formal system of non-salary controls.

100. Other internal control rules and procedures exist but consist only of a basic set of rules for processing and recording transactions (they are the same as before the SISTAFE law and regulations). In some areas, rules and procedures are deficient while in other areas of minor

importance controls are excessive. The degree of compliance with rules for processing and recording transactions is reportedly quite high but there are procedures which are applied without adequate justification and/or because the rules are not totally clear.

101. The **Internal Audit function** covers the majority of central government entities (if measured by the value of expenditure that they represent on the state budget). However, many of these internal audits are performed directly by IGF and only a minority of ministries have operational IA units of their own. Nevertheless, in aggregate a coverage of more than 50 % of central government expenditure is achieved. Internal audits focus on systemic issues and generally meet professional standards. In 2004, 73% of the total of inspections planned by IGF were carried out. (A total of 12, 092 of inspection days were used in 2004, with 94 inspection activities brought forward to 2005.) Activities planned and carried out did not reach a 100% level due to (i) the performance of activities not originally planned and (ii) time allocations exceeded in the planned inspections. Such adjustments are quite normal in Internal Audit operations and, in general, we would judge the planning and organisation of IA activities to be of a high quality, given the evident capacity constraints.

102. IA Reports are issued regularly for all inspected entities but they are only submitted to the inspected entity and to the Ministry of Finance. Audited entities have 15 to 45 days to reply to IGF. A final draft is then sent to the Ministry of Finance and audited entity. In general, international good practice would be to forward IA reports also to the Supreme Audit Institution (SAI – the *Tribunal Administrativo* in the case of Mozambique), so that external audits can assess the degree of follow-up to IA recommendations. Within the audited entities, management response to internal audit findings takes place on major issues, but often with delays and without close follow-up. In 2004, only 50% of audited entities kept IGF informed on developments in response to the recommendations received.

Developments during 2005 and prognosis for 2006

103. The weaknesses in payroll, procurement and control systems are serious and difficult to address in the short-term. They will require fundamental improvements in systems and procedures, as well as an associated programme of capacity-building. Although some reform measures have been initiated – in particular relating to procurement and Internal Audit, this is perhaps the area of PFM upgrading where reform actions are least advanced and the structures for coordinating and driving reforms are least well embedded:

- **Improvement in payroll controls** will depend on the establishment of an accurate, up-to-date, independent personnel data-base against which the payroll can be formally reconciled at least on a 6 monthly basis. It will also require procedures to ensure that processing of changes to payroll/ personnel records takes no longer than 6 months. The first step is to develop a coherent, resourced programme for achieving these changes. The initial diagnostic assessments necessary for the development of such a programme took place in the last quarter of 2005. These need to be assessed for their completeness and converted into a costed plan of action.
- The 2002 CPAR proposed a **procurement** reform programme. Recently, steps have been taken to clarify and improve the legal framework for public procurement²⁶ but

²⁶ For example, in April 2004 the 1996 procurement law was amended. This had permitted bidders to make payments of administrative costs to procurement officers. A new procurement code has also been approved by Decree in December 2005.

there is a huge vacuum of professional expertise in this area²⁷. This will impede the decentralisation of procurement authority, which is crucial to improving value for money. Significant short-term improvements are unlikely: steady progress towards long term gains should be the goal.

- Improvements in **non-salary expenditure controls** will depend on the establishment of an effective expenditure commitment control system. The e-SISTAFE system makes provision for this but will not be fully in place before 2007 or 2008.

There is a strategic plan for the development of **Internal Audit** which is currently under implementation. If this can impact on the speed and effectiveness of follow-up actions within audited entities, scoring against this indicator will improve. It is also important to formally include TA in the distribution of IA reports. In terms of extending IA coverage to all government entities, there is a major capacity development challenge, which Mozambique can only hope to address over the medium term.

3.5 Accounting, recording and reporting

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-22	Timeliness and regularity of accounts reconciliation	B
PI-23	Availability of information on resources received by the service delivery units	C
PI-24	Quality and timeliness of in-year budget reports	C+
PI-25	Quality and timeliness of annual financial statements	C+

104. Regular **bank reconciliations** for all Treasury managed bank accounts – including both the CUT and the *Contas subsidiaries*, take place monthly. The CUT is reconciled daily but its coverage is limited and does not allow total reconciliation of all central government bank accounts – in particular there are many off-budget project accounts and several autonomous (or semi-autonomous) government agencies that have separate bank accounts, in particular for own revenues (*receitas propias*). The institutions responsible for these accounts are required to submit bank reconciliations on a monthly basis to DNCP but we were unable to verify that this requirement is met on a comprehensive and consistent basis.

105. Advances are limited to those made under the *sistema duodecimal*, in which a monthly acquittal of advances is submitted by the different spending agencies. The accounting system does has a procedure for the creation of suspense accounts, in which account can be kept of unacquitted advances or other expenditures where irregularities appear. Amounts registered in these suspense accounts are deducted from the subsequent duo-decimal transfer, creating a

²⁷ The CPAR (2002) pinpointed ‘the vacuum of professional expertise’ as the fundamental constraint in this area. Unfortunately, until the legislative and regulatory framework for procurement is revised, the broad-based capacity-building process necessary for its implementation cannot start. Thus, improved procurement practices have tended to rely on ad hoc initiatives in particular sectors or institutions.

strong incentive for a timely and complete reconciliation. There is thus no significant build-up of suspense accounts pending reconciliation and there is a formal procedure for these to be cleared at end of year. On the other hand, the reconciliation of uncleared balances at the end of the fiscal year can sometimes be hurried and “ad hoc” if the necessary information for a proper reconciliation is not available.

106. The **information available on resources received by front-line service delivery units** is quite limited within the accounting system itself. This is because both the Budget Execution Reports and the *Conta Geral do Estado* are presented in an aggregated form according to the main organic (administrative) classification²⁸. More disaggregated accounts are kept at the provincial and line ministry levels and this more detailed information will be available centrally once the e-SISTAFE is fully operational. In the meantime, there was a substantial Expenditure Tracking & Service Delivery Survey (ETSDS) undertaken in 2002/03, covering the health sector. This analysed the level of authorised expenditures in relation to approved budgets in a representative sample of provincial and district departments. The hypothesis tested was that delays in budget execution and weak systems of control were having an adverse effect on the quality of service delivery. In practice, the ETSDS found that record-keeping was so poor that it was impossible to determine the degree of ‘leakage’ between provincial and district levels. However, it did reveal important information about the system’s real mode of operation and pointed the way to improvements in the funding of district health services. Unfortunately, there are no current plans to repeat the survey nor to undertake an equivalent survey in education.

107. With regard to the **quality and timeliness of in-year budget reports**, Budget Execution Reports (BERs) are issued quarterly within 6 weeks of the end of the quarter. Direct comparison to the approved budget estimates is only possible for the main administrative headings. In addition, up to the end of 2004, the coverage of the BERs was narrower than the approved budget estimates because it tended to be limited to expenditures managed through the CUT, whereas the budget also included estimates for (on-budget) donor financed project expenditures and for some expenditures managed from *receitas propias*. Thus, although the BERs are regular and timely, up to the end of 2004, there remained significant problems of comparability to the budget and to the final accounts of expenditure. Moreover, as a budget monitoring tool, the use of the BERs is limited by the fact that they only report payments because as we have noted above there is no formalised process for the recording of expenditure commitments at the central level.

108. A **consolidated annual financial statement** is prepared on a regular basis (*Conta Geral do Estado*). The detail of information in relation to revenue, expenditure, bank balances and financial assets may not always be complete but the omissions are not so significant as to undermine its utility. The level of detail on income and expenditure could be much higher than it actually is and is expected to be expanded with the new classification system for e-SISTAFE. Since 2004, the *Conta Geral do Estado* has been submitted for external audit within five months of the end of the fiscal year since 2004. The statements have been presented in a consistent manner over the last few years with some disclosure of accounting standards used, but there are points of inconsistency with international standards.

²⁸ From 2006, expenditures will also be reported in the quarterly BERs and in the CGE following a programmatic classification.

Developments during 2005 and prognosis for 2006

109. Accounting and reporting systems will be fundamentally upgraded with the full implementation of e-SISTAFE and therefore the primary focus in this area has been on the SISTAFE design and development process. This is clearly appropriate if sustainable improvements are to be made for the long term. However, the effectiveness of decision-making on the budget depends crucially on the quality of accounting information and financial reporting. At present, this is hampered by the incompleteness of the coverage of financial reports, as well as by the use of formats which are not “user-friendly”. These are areas where there is potential for short term gains in quality through a careful re-engineering of existing systems. We would therefore recommend an internal review (by DNCP, DNT, DNO and UTRAFE) of the existing bank reconciliation reports, BERs and the CGE. This should take place early in the first quarter of 2006 and should aim at introducing quick changes to be incorporated into the first quarterly BER so as to then avoid further changes in the course of the fiscal year²⁹. Improvements have already started to be made during 2005 and essentially what is required is to deepen the refinements already being introduced.

110. Among the changes which might be considered are:

- Improvements in the regularity and timing of expenditure reports on donor-financed projects and on activities financed from *receitas proprias* so that this information becomes incorporated more consistently in the BERs.
- Ensuring that there is proper documentation in all reports on the known areas of omissions and on their approximate significance.
- Subject to the limits of current information flows, increasing the degree of detail provided within each administrative head so as to have a view on spending by sub-sector, programme or function. (We were advised that such a breakdown is expected to be introduced at least for selected ministries and institutions from 2006.)
- Re-examining presentation formats so as to make reports more useful for management purposes.

111. The lack of information on resources received and used by front-line service delivery units presents a different and more intractable type of problem. Record-keeping at these levels is extremely poor and will not be improved by the SISTAFE reforms which are not currently planned to extend to the district level. In the short-term, the approach will need to rely on the use of ad hoc expenditure tracking and service delivery surveys, followed up by whatever practical, remedial measures could be introduced in the light of survey results. The 2002/ 03 Health ETSDS provided some practical proposals for improvements. A follow-up survey will need to be planned for 2007 or 2008 to assess how far these have been implemented and what the effects have been. In the meantime, an ETSDS for primary schools and district education services should be considered a high priority – if possible to be undertaken over 2006/ 07.

²⁹ A lack of consistency in formats has been one of the problems so it is important to avoid the continual introduction of changes to reporting formats on a quarter by quarter basis.

3.6 External scrutiny and audit

Assessment of PFM performance at end 2004

Indicator		Scoring
PI-26	Scope, nature and follow-up of external audit	D+
PI-27	Legislative scrutiny of the annual budget law	B+
PI-28	Legislative scrutiny of external audit reports	C+

112. The **scope and nature of external audit** in Mozambique is quite particular and needs to be understood if sensible comparisons are to be made to the internationally more standard institutional models for external audit³⁰. The supreme audit institution is the *Tribunal Administrativo*, which is directly responsible for auditing the individual accounts of government entities as well as the overall *Conta Geral do Estado*. In addition, it has a judicial status, acting as the *Tribunal de Contas* in reviewing and reaching final decisions over the audits of individual departments, as well as imposing fines and/ or initiating criminal investigations, where relevant. Thus, in its capacity as a *Tribunal de Contas*, the TA performs most of the functions performed by a Parliamentary Public Accounts Committee in a Westminster-based system. Only the audit of the CGE and the related audit opinion (*parecer*) of the TA is submitted to the *Assembleia da República*, providing the basis for their review and approval of the public accounts (*CGE*).

113. Because the *CGE* is a consolidated financial statement for the whole of central government, the TA's audit of this account cannot address detailed management questions on the use of funds and on procurement processes. Rather it considers its correctness and completeness as a set of consolidated accounts. The more detailed audit of transactions and of the functioning of internal control and procurement systems is undertaken through the ministry by ministry audits. For the moment this covers financial audit and does not yet include value for money auditing. The *TA* see the expansion of the coverage of financial audit as the most immediate priority before aspects of VFM auditing should be considered. Unfortunately, due to capacity constraints the TA cannot cover every agency annually; rather the intention is to cover all agencies over a 4 year cycle (ie. 25% of government entities per year)³¹. In the human resource context of Mozambique, it would be extremely difficult to achieve higher coverage but because international standards recommend 75-100 % coverage per year, the scoring against this indicator is low.

114. In terms of the timeliness of the audit of the *Conta Geral do Estado*, great progress has been made by the *Tribunal Administrativo*³². Following the requirements of the SISTAFE

³⁰ See also section 2.3.2 of this report.

³¹ We were advised by the TA that at present, the programme of audits is marginally behind schedule against this objective, although the team did not obtain records of the actual numbers of audits carried out.

³² The fact that the 1998 *CGE* could not be audited and presented to the National Assembly until 2001 gives a sense of how effectively the back-log of outstanding *CGE* audits has been subsequently cleared.

law, the *CGE* is audited annually between 31 May and 30 November of each year, so that an audit report reaches the National Assembly within 11 months of the end of the period covered. This requirement was fulfilled both in 2004 and 2005 (covering the 2003 and 2004 *CGEs*) following a prior ‘catch-up’ period, in which delays in delivering the TA’s *pareceres for the 2001 and 2002 CGEs* were addressed to comply with the new legislation.

115. Regarding the response to audit findings, the particularities of the Mozambican system hold some advantages, in that the TA is itself empowered to impose fines or initiate other corrective actions as a result of its departmental audits. We were advised that this had been done in a number of cases. In terms of the audit of the *CGE*, it is the *Comissão Parlamentar* who recommend follow-up measures and a report on their implementation is included in the TA’s audit report (*parecer*) for the following year’s *CGE*.

116. **Legislative scrutiny of the annual budget law** covers the annual plan (*PES*), fiscal policies, the medium term fiscal framework and medium term priorities as well as details of expenditure and revenue. The procedures adopted for the review are firmly established and respected. The Ministry of Finance has to submit the annual budget proposals to the *Assembleia da República* by 30th, September each year. The draft budget is then distributed to the six Parliamentary Committees, covering discrete sectoral areas, and to the *Comissão Parlamentar do Plano e Finanças*, which in addition to reviewing the proposed budget of the Ministry of Finance, plays an overall coordination role across the seven committees. The Committees have two months to review proposals, develop comments and negotiate relevant amendments with the Minister of Finance and his/her staff. In early December, the budget is then presented to the *Assembleia da República* for their consideration and approval. It is accompanied by a set of formal comments (*um parecer*) on the budget proposals by the *Comissão Parlamentar do Plano e Finanças*. The process of scrutiny of budget proposals by the Legislature is thus well developed and fully consistent with international good practice norms, although there is only limited evidence of a serious ‘challenge’ function played by Parliament. In addition, there are clear rules for in-year budget amendments by the Executive which are generally respected. They, nevertheless, allow for quite extensive administrative reallocations – a factor which has served to bring down the score for this indicator.

117. **Legislative scrutiny of the external audit report** usually takes place within 3 months of its receipt by the Legislature. As noted above this is led by the *Comissão Parlamentar do Plano e Finanças*, the same committee which leads the legislative scrutiny of the budget. Due to the current legal framework for the external audit process, scrutiny by the Legislature is limited only to the audit of the *CGE*, which provides the National Assembly with a highly aggregate picture of budget execution. It is this factor which pulls down the score against this indicator³³. Nevertheless, in-depth hearings on key findings do take place, although mainly with Ministry of Finance officials. Actions are also recommended to the Executive; there is evidence that some of these are implemented and there is a procedure for assessing follow-up. The type of corrective actions recommended usually refer to actions by the Ministry of Finance and are often system-wide in nature. For example, the 1998 *CGE* had no statement of State assets (*património do estado*) and the Legislature recommended its inclusion, as has been done since 2002. The launching of the SISTAFE initiative may also be

³³ The Chairperson of the *Comissão Parlamentar* expressed the view that this was an expedient arrangement in the short-to-medium term, given the tight constraints on auditing capacity and on capacity for financial scrutiny within Parliament. This is a position with which we have some sympathy.

said to be at least partly a response to criticisms by the Legislature over the quality of accounting and financial reporting.

Developments during 2005 and prognosis for end 2006

118. There are on-going capacity building initiatives both within TA and within the Legislature. Their impact can be clearly seen in the steady improvements in the quality of the reports (*pareceres*) of the *Tribunal Administrativo* and the *Comissão Parlamentar do Plano e Finanças*. The quality of legislative scrutiny of budget proposals is especially impressive, given the newness of the institutions and the inherent human resource capacity constraints of Mozambique. If the rules regarding administrative re-allocations of budget provisions could be tightened (so as to reduce the level of cross-ministerial re-allocations permissible without legislative approval), then the quality of legislative scrutiny would be more fully reflected in final budgetary outcomes and the scoring against this indicator (PI-27) would improve.

119. Improvements in the assessments of the quality of external audit and of legislative scrutiny of audit reports (Indicators PI-26 & PI-28) will depend on improving the coverage and timeliness of external audit. Essentially, coverage needs to be expanded from 25 per cent of government entities annually to 50 and then 75-100 per cent. This can only be done by increasing the number of qualified auditors within the TA and will necessarily be a slow process within the Mozambican context. As such no noticeable improvements in these indicators should be expected by 2007. Over the medium to long term, the Mozambican Government may wish to give consideration to expanding the role of the Legislature in relation to the scrutiny of external audit. But until there exists greater auditing capacity overall and greater capacity for scrutiny within the Legislature this should not be considered a priority.

3.7 Donor practices

120. This last set of indicators looks at donor behaviour, and gives an assessment of the degree to which donor practices impact on the performance of country PFM systems.

Assessment of PFM performance at end 2004

Indicator		Scoring
D-1	Predictability of Direct Budget Support	C+
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid	D+
D-3	Proportion of aid that is managed by use of national procedures	D

121. Mozambique has been receiving direct budget support since the late 1990s from a growing group of donors, which at this moment includes 17 bilateral and multilateral agencies. The main reciprocal commitments have been enshrined in a Memorandum of Understanding signed in 2004, which includes a number of undertakings by donors to improve aid effectiveness, including some of the issues covered by the PEFA indicators.

122. As far as **predictability of Direct Budget Support** is concerned, things have been steadily improving over the past three years, even though the overall score is still low. In terms of annual deviations, only in 2002 did disbursements fall short of the DNT forecast by more than 5 %. The main reason was a large disbursement foreseen for 2002 which only materialised in early 2003. For 2003 and 2004, as can be seen in the table below, final disbursements were even above initial forecasts, as more and more donors joined the group providing direct budget support.

123. In-year delays are a more common problem. At the outset of each fiscal year, DNT prepares a foreseen disbursement schedule on the basis of signed bilateral agreements. In all recent years, weighted disbursement delays in relation to this schedule were above 25%. (See Annex 4 for full details.) This can and has led to problems for the Government’s treasury, which in order to cover unexpected financing shortfalls has to resort to domestic financing via the issue of Treasury bills, increasing domestic debt. This is an area of ongoing concern for both donors and Government, and one where there is likely to be an improvement in the near future. Preliminary figures for 2005 already show an improvement in predictability, both in overall deviation and in weighted delays. For the period 2002-04, however, the score for this indicator is set as “C+”.³⁴

Total Annual Disbursements of Direct Budget Support in comparison with DNT forecast

	Forecast Disbursements* US\$m	Actual Disbursements* US\$m	Difference %
2002	90.2	66.0	-26.8%
2003	133.5	170.6	27.8%
2004	158.2	165.5	4.6%
2005**	206.9	210.6	1.8%

* Does not include World Bank PRSC

** Up to third quarter only

Source: DNT, Government of Mozambique

124. **Programme and project expenditure** is an area for which limited comprehensive information is available, both for budgeted and for executed expenditure. Aggregate information on this would be of great help in addressing budget coverage issues, and in improving overall planning. At the moment, donors are asked to provide information on externally-financed projects through summary tables submitted to DIC (Directorate for Investment and Cooperation, Ministry of Planning and Development), and through project sheets collected by the relevant sectors for inclusion in the *Plano Económico e Social* (PES). It is difficult to assess, however, whether the existing information is comprehensive. Its format, and the calendar according to which it is requested, does not allow for a significant fit with the Government’s budget calendar, and is not consistent with the government budget classification. Moreover, the information collected by DCI and the sectors is not cross-checked and integrated for use in the budget formulation process. At the moment, there is

³⁴ For a calculation of dimension (ii) of this indicator, related to weighted delays, see the last table in Annex 4.

inadequate coordination between DCI, the DNO and DNCP. Financial reports from donors on executed project expenditure are also submitted to the Government, but not for all projects and often with extensive delays, which prevents a useful consolidation in government reports.

125. The **use of national procedures in managing donor-financed activities**, in areas such as procurement, disbursement/ accounting, reporting and audit, is at the moment restricted to direct budget support. (15-20% of aid flows to central government). Some donor-financed projects use national procedures for disbursement and accounting but not for other aspects of management. Sector programmes, which are gradually shifting towards the use of national systems, are still not fully aligned, mostly due to concerns regarding procurement practices and due to audit requirements which can only be met through externally commissioned audits by the private sector. Overall, substantially less than 50 % of aid funds to central government are managed through national procedures, giving a “D” score.

Developments during 2005 and prognosis for end 2006

126. The harmonization and alignment of Donor practices have been the subject of extensive debate in Mozambique. If this is to generate real improvements in actual practices, it will be important for this debate to focus more precisely on the specific improvements which are most needed and also feasible in the short term. In relation to the use of national procedures, the low score in part reflects the nature of donor procedures for managing funds but it also reflects concerns over the poor quality of government processes of procurement and over the limited audit capacity. The present PEFA assessment demonstrates that there is some basis for these concerns, and that national procedures in these areas are unlikely to improve significantly in the short- to medium-term.

127. On the other hand, there is no reason why significant improvements should not be achieved in the predictability of budget support and in the provision of budgetary and expenditure data on external flows. This will require that the pledges which agencies have made in these areas should be converted into concrete and properly resourced action plans. The starting point must be the recognition by all donors that information needs to be provided to Government on a comprehensive basis, at specific points in the year dictated by the requirements of the budget cycle and using formats which are consistent with government expenditure classifications. To an extent, the establishment of the Government-Donor Task Force on off-budget spending has begun to address these issues but there is a sense that the driving force behind the Task Force is from the donor side. Government should take a lead in defining the necessary guidelines and systems with which donors need to comply, and in generating appropriate incentives by beginning to reject offers of external aid which do not comply with these requirements.

128. In addition, progress would be hugely facilitated if donors could appoint their own “managing agent” to play a “policing” role over donor practices and to co-ordinate the collection and submission of data to Government. With regard to budget support, the management “troika” which has been established for the PAPs is effectively a managing agent for the donors and is already helping to achieve improvements in the predictability of GBS disbursements. If a similar arrangement could be created to manage the transfer to Government of budgetary and expenditure data on all external finance, then fast improvements could be achieved on indicator D-2. Modifications in the format of the information requested, and in its timing, would directly improve the score, and provide a much more solid information basis for Government to utilise in increasing budget coverage.

To address some of these issues, an aid database was piloted by EU Member States in mid-2005, covering project data. This has now been extended to sector programmes and to all non-EU G17 partners and non G17 partners, such as Japan, the US and the African Development Bank. At the moment, inclusion of UN projects and programmes is ongoing, along with preparatory work to transfer the database to Government, with the necessary technical assistance. This instrument could contribute to improving the score on indicator D-2 in a number of ways, such as: (a) providing a comprehensive overview of all aid activities by sector and instrument; (b) providing quarterly information flows on aid-financed expenditure in a single format; and (c) providing payment forecasts by quarter for the following year.

4 RECOMMENDED STRUCTURES & PROCESSES FOR FUTURE PFM ASSESSMENTS

129. This Assessment is among the first being undertaken utilising the final PEFA methodology approved in July 2005. It therefore constitutes a further testing ground for the usefulness and user-friendliness of the indicators and related guidance. Moreover, the Terms of Reference required the study team to provide recommendations on the structures and processes for future assessments. This chapter briefly summarises the opinions of the team on the use of the PEFA methodology and on its suitability for Mozambique. It also presents recommendations for the establishment of a regular PFM assessment process which might contribute effectively to donor-government policy dialogue and, more importantly, to Government capacity to monitor and manage PFM reform.

4.1 Applicability of PEFA methodology to Mozambique

130. In overall terms, the PEFA methodology provided a very useful framework of analysis for assessing the quality of the PFM system in Mozambique. In particular, its objectivity and attention to analytical detail made the collection of necessary material straightforward, and the dialogue with government counterparts very constructive. Its focus on specific sources of information, and the limited space allowed for personal opinions to shape the scores on the different indicators, meant that discussion focused on matters of fact and substance, rather than on subjective interpretations.

131. In some areas, the difficulty in organising meetings with the correct individuals, and the delays in collecting all of the relevant information did not allow for an exhaustive set of data (in particular sectoral data) to be collected and analysed. Moreover, even at the central level, the interpretation and analysis of data was delayed by the significant amount of time that had to be devoted to its collection. In the future, the data requirements both within and outside the main central agencies should be addressed by ensuring that information is collected before the actual assessment takes place. As IGF and the other agencies of Government develop an increasing familiarity with the methodology, this should become easier to organise.

132. The highly structured nature of the methodology also means that it does not easily cater for the specificities of each country being assessed. Nor does it provide for the in-depth analysis of those aspects of the PFM system that deserve special attention beyond the limited picture given by the score for each indicator. In the case of Mozambique, some of the areas which require a more detailed analysis are:

- a) The **performance of decentralised/ deconcentrated PFM systems**, both at provincial/district and at municipality level. Here there is a need both to test the robustness of budgets as they move resources towards delivery points, and to come to a fuller understanding of interventions which might enhance the efficiency and effectiveness of public expenditure at lower levels of government.
- b) Again linked to public service delivery, the **interface of central and sectoral systems** for planning, budgeting, executing and reporting on public spending does not at the moment seem to allow for meaningful forward-planning and for proper tracking of public resources in order to link them with results. More needs to be known about how to introduce a performance orientation into budget systems and processes.

- c) More specific areas of budget management, such as **payroll** and **management of arrears**, are also difficult to assess in detail at the moment. There is a need for a closer analysis which provides more detailed data and information on existing systems, their shortcomings and potential solutions.

133. Nevertheless, it is important to remember that the PEFA methodology can provide no more than a photographic “snapshot” of the current performance of the PFM system. It is a comprehensive and objective “snapshot” and, as such constitutes an effective means for measuring progress over time. But it is not a diagnostic tool in the true sense of the word, in that, in most cases, it cannot generate sufficient information to explain why things are not working better. Nor is it a work-planning tool to manage the design and sequencing of PFM reforms. It therefore needs to be complemented both by more detailed studies of specific aspects of the PFM system and by annual planning and review workshops to update and refocus the PFM reform programme.

4.2 Proposed structure & instruments for future PFM assessments

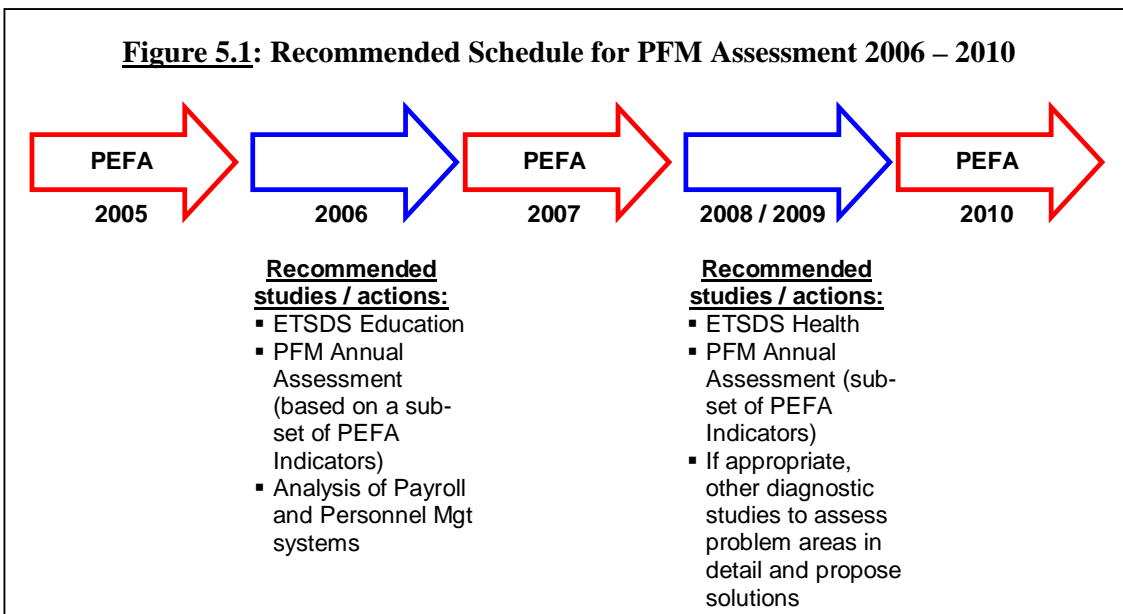
134. The indications of the PEFA Secretariat are that PFM assessments should be carried out every 3-5 years, to allow for reforms to take their course and generate significant impact on the relevant indicators. In the case of Mozambique, the MoU for Programme Aid (Budget Support) and the associated Performance Assessment Framework foresees an annual assessment process. Clearly, an annual PEFA assessment would be excessive but it does seem reasonable for the PAPs to receive an annual assurance, firstly, that the normal requirements of public finance legislation are being fulfilled and, secondly, that PFM reforms are being pursued in a serious manner. In the current context of Mozambique, it would also seem that the intense pace of PFM reforms probably deserves closer follow-up in order to ensure that the focus of actions is right and that results are being achieved.

135. In the light of these considerations and the limitations of the PEFA methodology noted above, it is therefore recommended that:

- a) The next assessment using the full PEFA methodology and involving a team of external consultants should be carried out in the fourth quarter of 2007, to cover progress over 2005 and 2006 (years for which full data sets will be available by then, including the *Parecer do Tribunal Administrativo*), and to assess improvements against the results of the 2004 assessment.
- b) The next full PEFA Assessment should be carried out in the fourth quarter of 2010, covering the subsequent 3 years.
- c) In order to feed into the yearly joint review process, a reduced assessment should be carried out on a yearly basis in the other years (2006, 2008 and 2009), by a team composed of government officials, donor agencies and civil society representatives. This should examine a sub-set of PEFA indicators, from which an assessment might be made of overall PFM out-turns (indicators PI-1 to PI-4), of donor practices (D-1 to D-3) and of five aspects of “due process” in the operation of the budget, namely public access to fiscal information (PI-10), orderliness and participation in the annual budget process (PI-11), quality and timeliness of in-year budget reports (PI-24), scope and nature of external audit (PI-26), and legislative scrutiny of the annual budget law (PI-27). In practice, given the need for the CGE to have been finalised prior to this

‘reduced assessment’, it will need to take place in the 3rd or 4th Quarter of the year, which will in turn require some re-organisation of the respective roles of the annual and half-yearly joint reviews of budget support.

- d) In addition, there should be an annual review of the progress reports of ongoing PFM reform projects (notably the e-SISTAFE project reports) so as to ensure that reforms are being conducted efficiently and that planned outputs are being generated. In those years where a fuller PEFA assessment was available, the PEFA report would provide the information base to judge the impact of reforms and to consider the possible need to refocus reforms on different priorities and/or to adjust the pacing and sequencing of individual components. We would recommend that the Government should organise this overall review of the progress of reforms in January or February of each year.
- e) In order to guide the detailed design of reforms, there will occasionally be a need for more detailed studies aimed at diagnosing problems and identifying the most appropriate solutions. For example, the 2004/05 PEFA assessment points clearly to the need for a detailed analysis of payroll controls to be undertaken during 2006 so as to inform the design of improvements in this area³⁵.
- f) Expenditure tracking and service delivery studies will also need to be undertaken on a periodic basis so as to complement the results of a PEFA assessment with a more detailed appreciation of the status of service delivery processes at the local level. We would recommend that an education ETSDS should be carried out in 2006 and that an ETSDS should be repeated for Health in 2008.



³⁵ The diagnostic assessments undertaken in the final quarter of 2005 may fulfil this purpose or may need to be complemented with additional studies.

4.3 Building capacity for PFM assessments

136. The PEFA assessment process is designed as an independent assessment, to be undertaken by relevantly qualified professionals, who are external both to Government and the donor agencies. It is important to retain this structure in order to avoid the potential for conflicts of interest and ensure the maximum level of objectivity. In the case of Mozambique, it would seem most appropriate, at least for the foreseeable future, for the PEFA assessment process to be undertaken by a mix of international and local consultants. However, it is important to support the development of adequate technical capacity in the use of the methodology and in the interpretation of its indicators within the country, in particular by government officials working in the key institutions, such as Ministries of Finance and internal and external audit institutions. This allows for an informed dialogue over the results of the assessment and its implications. In the case of Mozambique, we have further proposed in 4.2 above that a 'reduced assessment' should be carried out on a yearly basis feeding into the ongoing joint review process for Budget Support. If this is carried out, as we propose, by a local joint team³⁶, then a more extensive development of technical capacity will be required.

137. This first PFM Assessment utilising the full PEFA methodology was carried out by a team of external consultants, but a specific emphasis was put on ensuring the maximum degree of capacity building during the work. A member of the *Inspecção Geral das Finanças* accompanied the work of the team during the whole duration of the study, and contributed significantly to internal discussions, collation of material and assessment. An inception seminar was organised to familiarise the relevant institutions about the purpose and content of the methodology. Other presentations were made to the *Grupo de Referência* and to the *Conselho Técnico do Ministro das Finanças*, where care was taken to clarify the nature of the indicators and the information that was being collected and analysed to derive the scoring.

138. A training session with government officials from IGF, the *Tribunal Administrativo*, and different directorates of the Ministry of Finance was undertaken on 8th, December, 2005 so as to familiarise 10-12 key *técnicos* with the methodology, with its framework of analysis and interpretation, and with the information needed to update the assessment. This will begin to create local capacity but further capacity building measures are likely to be needed during 2006 to guarantee a successful 'reduced assessment', and to further strengthen Government's understanding and ownership of the PEFA methodology.

4.4 Using the PEFA analysis to review PFM reform design

139. One of the fundamental objectives of undertaking PEFA assessments is to gauge the impact of PFM reforms on the performance of the PFM system as a whole. In general, reform monitoring processes are too detailed and too narrow in focus to provide a basis for assessing impact. They will permit managers and decision-makers to track whether the immediate outputs of existing programmes are being achieved but will not permit a judgement on outcomes. How far are reforms impacting on overall PFM performance? Do current reforms

³⁶ There are three reasons for proposing a local joint team: firstly and most importantly, it is essential to ensure that the dialogue around the use of budget support is an informed dialogue; the best way of achieving this is to engage the participants of GBS dialogue directly in the assessment of PFM. Secondly, the scale of the reduced assessment is modest and should not require specialist consultancy skills. Thirdly, the chosen indicators are amongst the most quantitative so any loss of objectivity seems unlikely.

need to be re-modelled or complemented by additional, new measures? The PEFA analysis does permit an informed judgement on these questions but is not sufficient in itself to determine how to adjust the PFM reform programme and to address the problem of reform co-ordination. A complementary process is therefore needed.

140. In general, the 2004/05 assessment has served to endorse the broad direction of the current reform programme in Mozambique. While not all reforms have yet achieved a real impact on PFM outcomes, they do all appear to be responding to genuine needs and to be addressing priority areas where improvements are needed. However, the assessment also pointed to areas where there appear to be gaps. In some cases, these constitute relatively simple improvements to existing processes – such as the presentation of the budget framework and CFMP to Cabinet or the development of a consolidated fiscal risk analysis, where ‘quick gains’ in the quality of PFM outcomes could be attained. In other cases, such as in relation to payroll controls, the gaps are more complicated to resolve but too serious to leave unaddressed. Overall though, it seems clear that the PEFA analysis has provided new information which those leading PFM reforms within government will need to consider.

141. It will be important for Government to find a way to contemplate the results of the PEFA exercise and assess its implications for the current design of reforms. We would strongly recommend the organization of a review workshop in February 2006, where such a process could take place. This should involve the Ministries of Finance and Planning together with the *Tribunal Administrativo*, UTRAFE and UTRESP. We believe that this internal review of PFM reforms should be established as an annual practice. It will therefore be important to give careful attention to the design and organization of the first such review so as to set a positive precedent for the future.

142. Table 2 below illustrates the types of reform measures which this workshop may need to contemplate in order to achieve both ‘quick wins’ in the quality of PFM outcomes, as well as longer term systemic improvements. Clearly, the management of reform actions across such a wide range of areas will represent a challenge for Government. The review workshop should therefore also begin to consider how to build upon and strengthen the existing PFM reform coordination arrangements³⁷.

³⁷ Subsequent to the drafting of this report, such a workshop did indeed take place at which a short term action plan for strengthening PFM was developed based on Table 2.

Table 2: Summary of Reform Actions identified to improve PFM Performance

IDENTIFIED REFORM ACTIONS	PEFA INDICATORS AFFECTED	
A. IMPROVEMENTS FORESEEN AS THE RESULT OF ONGOING REFORMS		
e-SISTAFE	PI-5	Classification of the budget
	PI- 20	Effectiveness of internal controls for non-salary expenditure
	PI-24	Quality and timeliness of in-year budget reports
	PI-25	Quality and timeliness of annual financial statements
Tax Reform Programme	PI-13	Transparency of Taxpayer Obligations and Liabilities
	PI-14	Effectiveness of measures for taxpayer registration and tax assessment
Strengthening of IGF	PI-21	Effectiveness of internal audit
Improved mechanisms for GBS disbursement	D-1	Predictability of Direct Budget Support
B. NEW MEASURES WITH A POTENTIAL FOR SHORT-TERM IMPACT		
Audit of outstanding Payments Arrears on Project Counterpart Funds	PI-4	Stock and monitoring of expenditure payment arrears
Presentation of Fiscal Deficit in line with GFS norms and inclusion of information on deficit financing, debt stock and financial assets.	PI-6	Comprehensiveness of information included in budget documentation
Timely & accurate provision of information to Municipalities on ceilings for the preparation of the 2007 budget.	PI-8	Transparency of inter-governmental fiscal operations
Preparation of a consolidated report on Fiscal Risk from public enterprises and State shareholdings, plus new procedures for monitoring fiscal risks from Municipalities.	PI-9	Oversight of aggregate fiscal risk from other public sector entities
Development of a pro-active strategy of prompt dissemination of fiscal information.	PI-10	Public access to key fiscal information
Revision of budget preparation calendar to permit Cabinet approval of CFMP	PI-11	Orderliness and participation in the annual budget process

IDENTIFIED REFORM ACTIONS	PEFA INDICATORS AFFECTED	
Legal and regulatory amendments to reduce the level of cross-ministry budgetary re-allocations made within the budget year, without Parliamentary scrutiny.	PI-16	Predictability in the availability of funds for commitment of expenditures
Review in 1ST quarter of 2006 of the format and preparation procedures for Budget Execution Reports, so as to improve the consistency and breadth of their coverage.	PI-27	Legislative scrutiny of the annual budget law
Review in 1ST quarter of 2006 of the format and preparation procedures for the CGE, so as to improve its content, presentation and consistency with international accounting norms.	PI-24	Quality and timeliness of in-year budget reports
Detailed programme of actions by the Government-Donor Task Force on off-budget spending to improve timing and presentation of project expenditure information for consistency with GdM Budget needs.	PI-25	Quality and timeliness of annual financial statements
Detailed programme of actions by the Government-Donor Task Force on off-budget spending to improve timing and presentation of project expenditure information for consistency with GdM Budget needs.	D-2	Financial information provided by donors for budgeting and reporting on project and programme aid
	PI-7	Extent of unreported government operations
C. NEW STRUCTURAL REFORMS WITH A POTENTIAL IMPACT OVER THE MEDIUM TO LONG TERM		
Increased use of the Single Treasury Account (CUT) by externally financed projects.	PI-16	Predictability in the availability of funds for commitment of expenditures
	PI-17	Recording and management of cash balances, debt and guarantees
Development of a coherent, adequately resourced programme to strengthen payroll controls, based upon: 1) Establishment of a comprehensive, accurate and up-to-date Personnel data-base, against which payroll payments can be systematically reconciled at least on a 6 monthly basis. 2) Procedures to ensure that adjustments to the payroll or personnel data-bases are processed in less than five months.	PI-18	Effectiveness of payroll controls
Organisation, design and completion of an Expenditure Tracking & Service Delivery Survey (ETSDS) for primary schooling.	PI-23	Availability of information on resources received by service delivery units

IDENTIFIED REFORM ACTIONS	PEFA INDICATORS AFFECTED	
D. IMPROVEMENTS DEPENDENT UPON DEVELOPEMENT OF INSTITUTIONAL CAPACITY OVER THE MEDIUM TO LONG TERM		
Strengthening of sectoral and central level capacities for policy analysis, sector strategy development and medium-term planning.	PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
Strengthening of the capability of the Repartições de Finanças to prepare tax assessments and undertake tax collections efficiently.	PI-15	Effectiveness in collection of tax payments
Comprehensive training throughout sector ministries and provinces in procurement techniques and processes, so as to establish an appropriate and operational structure of Tender Boards and procurement advisors.	PI-19 D-3	Competition, value for money and controls in procurement Proportion of aid that is managed by use of national procedures
Development of audit capacity within the <i>Tribunal Administrativo</i> .	PI-26 PI-28	Scope, nature and follow-up of external audit Legislative scrutiny of external audit reports

ANNEX ONE

Summary of PFM Performance Indicators at end 2004

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
A. PFM OUT-TURNS : Credibility of the Budget					
PI-1	Aggregate expenditure out-turn compared to original approved budget	(i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure)		A	In 2002, the year in which a supplementary budget was passed in September, the aggregate expenditure out-turn compared to the original budget was 103.7%. In 2003 it was 89.2%, while in 2004 it was 96.3%. Thus in two out of three years, it deviated from budget by less than +/- 5%.
PI-2	Composition of expenditure out-turn compared to original approved budget	(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years		B	The variance in the composition of expenditure out-turns additional to overall aggregate variance (as measured under PI-1) was 6.7% in 2002, 4.6% in 2003 and 3.9% in 2004.
PI-3	Aggregate revenue out-turn compared to original approved budget	(i) Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget		B	Aggregate revenue out-turn corresponded to 101.6% in 2002, 94.9% in 2003 and 89.7% in 2004. Thus, in 2 out of 3 years, it was above 94 % of budgeted revenue.
PI-4	Stock and monitoring of expenditure payment arrears	A	(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in	D+	Data available for the 2003 ' <i>periodo complementar</i> ', indicate that arrears were less than 1% of total expenditure. Donors report current arrears on project counterpart fund payments but it is doubtful overall

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		the stock			arrears exceed 2 % of total exp.
		(ii) Availability of data for monitoring the stock of expenditure payment arrears	D		There are no clear data available on arrears after 2003 when the ' <i>período complementar</i> ' was abolished. There is no centralised recording process for payments arrears.
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency					
PI-5	Classification of the budget	(i) The classification system used for formulation, execution and reporting of the central government's budget		B	Budget formulation and execution is based on economic, administrative and functional classification. In budget formulation, however, functional classification is limited to main functions, while in budget execution reports it is complete but probably inaccurate because coded centrally.
PI-6	Comprehensiveness of information included in budget documentation	(i) Typology of information in the budget documentation most recently issued by the central government		B	Budget documentation does not include detailed information on fiscal deficit (according to international standards), deficit financing, debt stock and financial assets
PI-7	Extent of unreported government operations	(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported i.e. not included in fiscal reports	B	C+	Based on available reports of off-budget spending from <i>receitas próprias</i> , these may be estimated as greater than 1 % but less than 5 % of total expenditure.
		(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports	C		Available information on grant-financed projects is seriously deficient.

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
PI-8	Transparency of inter-governmental fiscal operations	(i) Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government.	A	C+	Municipal legislation identifies clear criteria for allocating transfers. Until today, however, these are only partially applied.
		(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year	C		Formal communication of budget ceilings to municipalities happens only after the national budget has been approved by the <i>Assembleia da República</i> , in December.
		(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories	D		Final accounts include some summary information on municipal revenues and expenditures, but there is no consolidation according to sectoral categories.
PI-9	Oversight of aggregate fiscal risk from other public sector entities	(i) Extent of central government monitoring of autonomous government agencies and public enterprises	C	D+	DNT receive quarterly financial reports on PE performance and IGEPE receive reports on companies with public shareholdings. However, these are not consolidated into an overall assessment of fiscal risk.
		(ii) Extent of central government monitoring of SN governments' fiscal position	D		While in general Municipalities do not incur significant debt, because legislation does not allow it, there is no regular monitoring of their fiscal position, and problems, when they arise, are dealt with in an ad-hoc manner
PI-10	Public access to key fiscal	(i) Typology of fiscal information which is publicly available		C	A growing quantity of information is made available to the public, especially through websites, but in a form

INDICATOR		Dimensions to be assessed	2004 Scoring	COMMENTS
	information			which is often incomplete, not easily understandable, and with significant delays. Moreover, there is no information available on contract awards and on resources available to primary service units.
C. BUDGET CYCLE				
C (i) Policy-based Budgeting				
PI-11	Orderliness and participation in the annual budget process	(i) Existence of and adherence to a fixed budget calendar	A	B There is a clear budget calendar in the SISTAFE Law and regulations. Apart from occasional delays, this calendar is generally followed, and gives agencies two months to prepare detailed budget proposals. Decisions about budget ceilings are not approved by Cabinet, but delegated to the Minister of Finance. Cabinet only approves budget estimates once agencies have submitted their proposals and these have been consolidated by MF The Assembleia da República normally approves the budget in December, in line with legal requirements. However, the 2005 budget was not approved until May 2005, due to post-electoral delays. Thus, in one of the last three years, there was a delay in excess of two months.
		(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent)	C	
		(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years)	C	
PI-12	Multi-year perspective in fiscal planning, expenditure policy	(i) Preparation of multi-year fiscal forecasts and functional allocations	C	C+ A Medium Term Fiscal Framework (the <i>CFMP</i>) is prepared on an annual basis, with projections for three years and an indication of sectoral allocations. However, the linkages between CFMP projections and OE budget

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
	and budgeting				allocations for the following years are still unclear.
		(ii) Scope and frequency of debt sustainability analysis	A		DSAs of external and domestic debt are undertaken annually in the context of IMF Article IV discussions. DNT will take direct responsibility for this from 2006.
		(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure	C		The majority of main sectors have sector strategies, but in many cases these are not fully costed, and are not linked to fiscal projections.
		(iv) Linkages between investment budgets and forward expenditure estimates	C		In very few cases is there a clear link between investment projects and implications for future recurrent expenditures. In several sectors investment decisions do not seem to be taken on the basis of strategic plans.
C (ii) Predictability and Control in Budget Execution					
PI-13	Transparency of Taxpayer Obligations and Liabilities	(i) clarity and comprehensiveness of tax liabilities	B	B	Legislation and administrative procedures for major taxes are comprehensive and clear and the discretionary power of the Repartições de Finanças is reasonably limited.
		(ii) Taxpayer access to information on tax liabilities and administrative procedures	A		Tax payers have easy access to information on tax liabilities and administrative procedures; the information is user friendly and up-to-date and the Repartições de Finanças play an active role in taxpayer education and information.
		(iii) Existence and functioning of a tax appeal mechanism	C		There is a tax appeal mechanism set up but it is not totally functional due to issues which have arisen regarding its

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
					efficiency, fairness and effective follow up.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	(i) Controls in taxpayer registration system	B	C+	Taxpayer registration is managed through a database for individual and corporate taxes. The NUIT: Número Único de Identificação Tributária is used in other government databases (namely registration/licensing functions) as the reference number but, in general, direct linkages to other government systems and financial sector regulatory processes are weak.
		(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	C		Tax assessment is supported by a system of penalties for non-compliance. Although penalties exist for most relevant taxes, they are not totally efficient due to their limited application. The problem appears to be that the current sanctions regime is too rigid, with penalties out of proportion to the sums involved in non-compliance.
		(iii) Planning and monitoring of tax audit and fraud investigation programs	C		25 senior audits are planned annually (central and provincial level) but the audit planning is not yet a properly programmed process based on clear risk assessment criteria.
PI-15	Effectiveness in collection of tax payments	(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	D	D+	The debt collection ratio for gross arrears is much below 60%. The total amount of tax arrears appears to be significant and steps to identify and clear those outstanding tax arrears, which remain valid, have only recently been initiated and have not been completed.

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		(ii) Effectiveness of transfer of revenue collections to the Treasury by the revenue administration.	B		The transfer of tax collections to the Treasury by the revenue administration has generally been made weekly or more frequently. With SISTAFE fully operational, direct payments to the CUT will be made by taxpayers.
		(iii) Frequency of complete accounts reconciliation between assessments, collections, arrears and receipts by Treasury	B		A reconciliation of tax collections and transfers to the Treasury takes place at least once a week. A complete reconciliation of assessments, payments, transfers to the Treasury and outstanding arrears is undertaken quarterly
PI-16	Predictability in the availability of funds for commitment of expenditures	(i) Extent to which cash flows are forecast and monitored	A	D+	Cash flow forecasts are prepared for the fiscal year and updated and monitored every week by the Treasury on the basis of actual cash inflows and outflows. Information about the flow of investment expenditure (off-budget projects) is still weak. DNT and DCI need to perform a reconciliation exercise for the information they have and to establish a communication process between them.
		(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	C		Information to budget entities on ceilings for expenditure commitment is made for two months in advance according to the duodecimal method of budget transfers. Ideally ceilings should be quarterly or 6 monthly. Moreover, the current system is focused on spending against the recurrent budget and does not provide information on counterpart fund payments for donor-financed projects or on the donor flows themselves.
		(iii) Frequency and transparency of adjustments to budget allocations,	D		Up to the end of 2004 significant in-year budget adjustments decided above the level of management of

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		which are decided above the level of management of MDAs			budget entities were frequent and not done in a transparent manner, i.e., they were made without the knowledge and involvement of the budget entities.
PI-17	Recording and management of cash balances, debt and guarantees	(i) Quality of debt data recording and reporting	B	B+	External debt records are complete, updated and reconciled on a monthly basis through the CS-DRMS system. Domestic debt records are kept separately and a monthly reconciliation is carried out. A comprehensive statistical report on debt service, stock and operations is prepared annually but not quarterly.
		(ii) Extent of consolidation of the government's cash balances	B		Most of government's cash balances are calculated and consolidated weekly, but there are substantial off budget funds outside this arrangement. The CUT is reconciled daily through the e-Sistafe and BdM's STF system.
		(iii) Systems for contracting loans and issuance of guarantees	A		The systems for contracting loans and issuance of guarantees is clear, made within the limits for total debts and total guarantees, with the Ministry of Finance as the sole entity responsible for approvals.
PI-18	Effectiveness of payroll controls	(i) Degree of integration and reconciliation between personnel records and payroll data	D	D+	There is no effective integration and reconciliation between personnel records (where MAE's SIP system is not fully updated) and payroll. In addition, there are 12 payrolls at the national level and no integrated payroll list.
		(ii) Timeliness of changes to personnel records and the payroll	D		Delays in processing changes to personnel records & payroll are often significantly longer than three months and require widespread retroactive adjustments due to the delays of receiving TA "vistos". CPD has the capacity to

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
					do changes on a monthly basis but requires DNCP to provide accurate and timely notification of changes, based on data received from budget entities.
		(iii) Internal controls of changes to personnel records and the payroll	C		Internal controls of changes to personnel records and the payroll exist but are not adequate to ensure full integrity of data.
		(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers	C		Partial payroll verifications to identify control weaknesses and/or ghost workers have been carried out by CPD within the last three years but not according to an annual systematic plan. IGF includes payroll verification and audit within its mandate but information on findings and respective follow-up was unavailable.
PI-19	Competition, value for money and controls in procurement	(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold)	C	C	The data available in DNPE Activity Plan / Annual Balance showed that less than 50% of contracts above the national threshold for small purchases are awarded on an open competitive basis. These data may not be accurate but appear to conform to known practices.
		(ii) Extent of justification for use of less competitive procurement methods	C		Regulatory requirements clearly establish that open competition should be the preferred method of competition, although State institutions often use other methods of procurement permitted by the existing legal framework. Justifications for the use of these less competitive procurement methods are weak, missing or

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
					unclear.
		(iii) Existence and operation of a procurement complaints mechanism	C		There is a procurement complaints mechanism in place but it is poorly designed and does not operate in a manner to promote transparency, confidence and timely resolution of complaints.
PI-20	Effectiveness of internal controls for non-salary expenditure	(i) Effectiveness of expenditure commitment controls	D	D+	Expenditure commitment controls are lacking at central level. Budget entities are required to record expenditure commitments against budgets but these are not systematically reported to DNCP or DNT nor are they systematically registered at the central level. There are also reasons to doubt that these requirements are comprehensively applied by budget entities.
		(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures	C		Other internal control rules and procedures exist, but consist only of a basic set of rules for processing and recording transactions, which are understood only by the staff most directly involved in utilising these procedures. Currently, these are the same as before the SISTAFE law and regulations and are in need of updating.
		(iii) Degree of compliance with rules for processing and recording transactions	C		The degree of compliance with rules for processing and recording transactions is fairly high but there are procedures that are applied without adequate justification and/or because the rules are not totally clear.
PI-21	Effectiveness of internal audit	(i) Coverage and quality of internal audit function	B	C+	Although only a minority of ministries have operational IA units, the audits carried out by these units together with those carried out by IGF at the central level cover

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
					over 50% of budget expenditure. Internal audits focus on systemic issues and generally meet professional standards. In 2004, 73% of the total of inspective actions planned by IGF were carried out.
		(ii) Frequency and distribution of reports	C		Reports are issued regularly for all inspected entities but they are only submitted to the inspected entity and to the Ministry of Finance, and not to the TA (the Supreme Audit Institution), which would be the international good practice norm.
		(iii) Extent of management response to internal audit findings	C		Management response to internal audit findings takes place on major issues but often with delays. In 2004, only 50% of audited entities kept IGF informed on developments in response to the recommendations received.
C (iii) Accounting, Recording and Reporting					
PI-22	Timeless and regularity of accounts reconciliation	(i) Regularity of bank reconciliations	B	B	The CUT is reconciled daily but its coverage is limited and does not allow total reconciliation of central government bank accounts. There are many off-budget project accounts and several autonomous (or semi-autonomous) government agencies that have separate bank accounts: the institutions responsible for these accounts are required to submit reconciliations on a monthly basis but the team were unable to verify that this requirement is consistently fulfilled.

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		(ii) Regularity of reconciliation and clearance of suspense accounts and advances	B		Advances are managed through the sistema duodecimal. Because the accounting system does not make provision for the creation of suspense accounts, all outstanding balances have to be cleared at end of year, if necessary through ad hoc procedures.
PI-23	Availability of information on resources received by service delivery units	(i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (primary schools and primary health clinics), irrespective of which level of government is responsible for the operation and funding of those units		C	Routine data collection and accounting systems are not sufficiently disaggregated to provide information on resources received by service delivery units. An Expenditure Tracking and Service Delivery Survey for health services was carried out in 2002/3. No other similar exercise has been carried out, or is currently planned.
PI-24	Quality and timeliness of in-year budget reports	(i) Scope of reports in terms of coverage and compatibility with budget estimates	C	C+	Comparison to budget estimates is possible only for main administrative headings with a high degree of aggregation. Expenditure is only captured at payment stage (not both at commitment and payment stage).
		(ii) Timeliness of the issue of reports	B		Regular quarterly Budget Execution Reports (BERs) are issued 6 weeks after the end of the quarter.
		(iii) Quality of information	C		Coverage of the BERs is limited to expenditures managed through the CUT and does not include all donor financed projects which are reflected in the budget. There are also question marks over the accuracy of the reports.

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
PI-25	Quality and timeliness of annual financial statements	(i) Completeness of the financial statements	C	C+	A consolidated government statement (the CGE) is produced annually. Information on revenue, expenditure, bank balances & financial assets is not always complete but omissions are not significant.
		(ii) Timeliness of submission of the financial statements	A		As of 2004, the annual financial statement (CGE) has been submitted for external audit within five months of the end of the fiscal year.
		(iii) Accounting standards used	C		The statements have been presented in a consistent manner and format over the last few years with some disclosure of accounting standards used, but there are points of inconsistency with international standards.
C (iv) External Scrutiny and Audit					
PI-26	Scope, nature and follow-up of external audit	(i) Scope/nature of audit performed (incl. adherence to auditing standards)	D	D+	Financial Audits are performed with general adherence to international auditing standards. However, due to capacity constraints, these can only cover the CGE and 25% of government entities annually.
		(ii) Timeliness of submission of audit reports to legislature	C		In 2004 and 2005, the <i>Conta Geral do Estado</i> for the previous fiscal year has been audited between 31 May and 30 November of each year, following the requirements of the SISTAFE law. (ie. Audit reports are submitted to the legislature within 11 months of the period covered.)
		(iii) Evidence of follow up on audit recommendations	B		Formal responses by audited agencies are made directly to the TA, who are mandated to instruct on the corrective

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
					actions to be taken. With only partial coverage of state entities, systematic follow-up of recommended corrective actions is not possible. For the CGE, the Parliamentary Commission/ Assembleia da República direct follow-up actions, which are reported on in the subsequent year's audit.
PI-27	Legislative scrutiny of the annual budget law	(i) Scope of legislature's scrutiny	A	B+	Legislature's scrutiny covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue.
		(ii) Extent to which the legislature's procedures are well-established and respected	A		The procedures adopted for the scrutiny of budget proposals are firmly established and respected. Relevant legal and organizational arrangements are in place, including precise roles for the different Parliamentary committees.
		(iii) Adequacy of time for the legislature to provide a response to budget proposals.	A		More than two months are given to the Legislature to review annual budget proposals.
		(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature	B		There are rules for in-year budget amendments by the executive which are respected but allow extensive administrative reallocations.
PI-28	Legislative scrutiny of external audit reports	(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years)	A	C+	The Legislature completes a scrutiny of the external audit report within 3 months from its receipt. (However, this report according to national legislation is limited to an aggregate audit of the CGE.)

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		(ii) Extent of hearings on key findings undertaken by the legislature	C		Because it is only the CGE audit which is submitted to the Legislature, in-depth hearings on key findings are generally limited to the MF. Entities audited individually by the TA are not subject to Legislative scrutiny.
		(iii) Issuance of recommended actions by the legislature and implementation by the executive	B		Actions are generally recommended to the Executive, and there is evidence that some of these are implemented. However, recommendations are system-wide (covering the CGE as a whole) and can be difficult to respond to in a timely manner.
D. DONOR PRACTICES					
D-1	Predictability of Direct Budget Support	(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the Legislature.	A	C+	In 2002, mostly due to a delayed disbursement, the shortfall reached 26.8%. In both 2003 and 2004, as more donors started to provide Direct Budget Support, final disbursements were higher than original forecasts.
		(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	C		Weighted disbursement delays were above 25% (but below 50%) for each of the three years considered.
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid	(i) Completeness and timeliness of budget estimates by donors for project support	C	D+	Donors provide information to the government through summary tables submitted to DCI and project sheets sent to the relevant sector. The majority of this information, although available, is not provided in adequate time to fit within the existing budget cycle, and is not consistent with the Government expenditure classification.

INDICATOR		Dimensions to be assessed		2004 Scoring	COMMENTS
		(ii) Frequency and coverage of reporting by donors on actual donor flows for project support	D		Financial reports from donors on project execution cover about 90% of projects, but are normally sent with considerable delay, towards the end of the year.
D-3	Proportion of aid that is managed by use of national procedures	(i) Overall proportion of aid funds to central government that are managed through national procedures		D	Only funds provided as Direct Budget Support fully satisfy the indicator criteria. These constitute about 15-20% of total aid received by the government. Thus, significantly less than 50% of aid funds to central government are managed through national procedures.

ANNEX TWO

Summary Estimation of Potential PFM Performance Ranking at end 2006

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
A. PFM OUT-TURNS : Credibility of the Budget				
PI-1	Aggregate expenditure out-turn compared to original approved budget	A	B	Aggregate results depend on a number of factors that are difficult to pin down precisely, and follow from the implementation of a number of reform measures. However, the delayed approval of the 2005 budget and the consequent discrepancies in 2005 out-turns will almost certainly have a negative effect on indicators.
PI-2	Composition of expenditure out-turn compared to original approved budget	B	B	
PI-3	Aggregate revenue out-turn compared to original approved budget	B	C	
PI-4	Stock and monitoring of expenditure payment arrears	D+	C+	A comprehensive, ad-hoc exercise during 2006 to describe and quantify existing expenditure payment arrears (especially on project counterpart funds) would improve the overall score.
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency				
PI-5	Classification of the budget	B	B	Improvements are needed to render the use of the functional classification more accurate and to ensure that the full set of 69 sub-functional COFOG classifiers are consistently employed. The introduction of SISTAFE can contribute to this, but an improved score is unlikely before 2007.
PI-6	Comprehensiveness of information included in budget documentation	B	A	The presentation of fiscal deficit information according to GFS standards, and the inclusion of more exhaustive information on

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				deficit financing, debt stock and financial assets should improve the score for this indicator
PI-7	Extent of unreported government operations	C+	B	Significant improvements in the recording of receipts and expenditures on grant-financed donor projects will be needed to improve the score on this indicator. However, ongoing efforts between donors and the Government, linked to the development of data bases by the European Union and the United Nations, can bring substantial improvements before the start of the 2007 fiscal year.
PI-8	Transparency of inter-governmental fiscal operations	C+	B	The provision of more timely information to Municipalities on their budget ceilings for the 2007 Budget (for example when ceilings are sent to central sectoral ministries) would improve the overall score. Greater improvements would depend on legislative revisions which are not likely to happen in 2006.
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D+	C+	The preparation of a consolidated fiscal risk report on public enterprises and state investments is a result that can be achieved with some technical assistance to DNT. This, combined with new procedures to monitor fiscal risks from municipal liabilities linked to the introduction of SISTAFE would improve the score for this indicator.
PI-10	Public access to key fiscal information	C	B	The timely release of information which is already being made available, through appropriate channels, and a more proactive dissemination strategy, could

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				improve the score for this indicator
C. BUDGET CYCLE				
C (i) Policy-based Budgeting				
PI-11	Orderliness and participation in the annual budget process	B	B+	Improvements must focus on adjusting the budget preparation calendar to involve Cabinet in approval of the CFMP as the basis for the fiscal strategy & budget ceilings.
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	C+	C+	No quick measures can be taken to improve the score on this indicator. Improvements will come from long-term capacity development in sector planning and fiscal forecasting capacity. In the short term, this will depend on establishing a national vision of the medium term planning process, which is consistently shared and followed by the Ministries of Planning and Finance, sector ministries and donor agencies.
C (ii) Predictability and Control in Budget Execution				
PI-13	Transparency of Taxpayer Obligations and Liabilities	B	A	Ongoing reform efforts, linked to the review of the appeals process & the establishment of the <i>Tribunais Fiscais</i> in 2006, should improve the score for this indicator.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C+	B	The most significant improvements in the registration of tax payers relate to the review of the penalties regime and the strengthening of the mechanisms for planning (and targeting) tax audits. With progress in these areas during 2006, the score against this indicator may also

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				rise.
PI-15	Effectiveness in collection of tax payments	D+	C+	Improved performance will depend on steps to identify and clear the outstanding tax arrears which remain valid. Instructions issued by DNIA to the <i>Repartições de Finanças</i> provide a way to achieve this but there is a question mark over the capacity to undertake such instructions promptly and efficiently.
PI-16	Predictability in the availability of funds for commitment of expenditures	D+	C+	Within year adjustments in budget allocations must be reduced and made more transparent. If this can be achieved, a modest rise in the scoring can be attained. Greater improvement will depend on extending cash-flow forecasting to investment spending and moving from 2 to 3 or 6 monthly credit limits on spending.
PI-17	Recording and management of cash balances, debt and guarantees	B+	B+	With the new debt strategy and the related capacity building, it should be possible during 2006 to start issuing comprehensive quarterly (rather than annual) reports on debt but improvements in this indicator will require a reduction in the level of funds passing outside the CUT.
PI-18	Effectiveness of payroll controls	D+	D+	Improvement in controls will depend on the establishment of an accurate, up-to-date, independent personnel data-base against which the payroll can be formally reconciled at least on a 6 monthly basis. It will also require procedures to ensure that processing of changes to payroll/personnel records takes no longer than 6 months. The first step is to develop a coherent, resourced

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				programme for achieving these changes.
PI-19	Competition, value for money and controls in procurement	C	C	The 2002 CPAR proposed a procurement reform programme. Recently, steps have been taken to clarify and improve the legal framework for public procurement but there is a huge vacuum of professional expertise in this area, which will impede the decentralisation of procurement authority. Significant short-term improvements are unlikely: steady progress towards long term gains should be the goal.
PI-20	Effectiveness of internal controls for non-salary expenditure	D+	D+	Improvements in this area will depend crucially on the establishment of an effective expenditure commitment control system. The e-SISTAFE system makes provision for this but will not be fully in place before 2007 or 2008.
PI-21	Effectiveness of internal audit	C+	B	There is a strategic plan for the development of Internal Audit which is currently under implementation. If this can impact on the speed and effectiveness of follow-up actions within audited entities, scoring against this indicator will improve. It is also important to formally include TA in the distribution of IA reports.
C (iii) Accounting, Recording and Reporting				
PI-22	Timeless and regularity of accounts reconciliation	B	B+	Improvements in this indicator will depend on expanding the coverage of the reconciliation process to cover all central government accounts (including off-budget projects and <i>receitas proprias</i>) and not just the

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				Treasury-managed accounts. Steady progress is being made, which may be sufficient to improve the scoring at end 2006.
PI-23	Availability of information on resources received by service delivery units	C	D	A new tracking survey to identify the level of resources received by either primary schools or primary health clinics (follow-up to the ETSDS) will need to be carried out in 2006 to maintain the present score for this indicator. This is not currently planned.
PI-24	Quality and timeliness of in-year budget reports	C+	B	Improvements in this indicator will depend on improving the accuracy/ consistency of BERs as well as their coverage. A quick review in 1stQ of 2006 of the current format & process of preparation of BERs could identify how to achieve quick improvements in these areas. The introduction of SISTAFE can also contribute to the overall consistency of BERs.
PI-25	Quality and timeliness of annual financial statements	C+	B	Here too the problem is not timeliness but coverage and quality. The full implementation of e-SISTAFE should bring major improvements but shorter term improvements should also be possible. Again, we recommend a quick review in 1 st Quarter of 2006 of the current format & process of preparation of CGEs.
C (iv) External Scrutiny and Audit				
PI-26	Scope, nature and follow-up of external audit	D+	D+	Improvements in this indicator will depend on improving the coverage of annual audit operations from 25 % of government entities (in addition to the CGE) to 50% and then 75-100%. Although audit capacity is

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				steadily improving, such a jump in the scope of audit coverage cannot be expected by end 2006.
PI-27	Legislative scrutiny of the annual budget law	B+	A	Legislative scrutiny of the budget proposals is well organised and generally effective. However, greater control is needed over the high level of in-year administrative re-allocations of the budget (without Legislative scrutiny); appropriate legal and regulatory amendments should be possible during 2006.
PI-28	Legislative scrutiny of external audit reports	C+	C+	The scope of legislative scrutiny of external audit reports is limited to the audit of the <i>CGE</i> , and therefore in-depth hearings are generally limited to interviews of MF officials. As audit capacity within TA and capacity for scrutiny within the Legislature expand, it may become appropriate to widen the scrutiny of the Legislature but such legislative amendments are unlikely to be relevant or workable before 2007 or 2008.
D. DONOR PRACTICES				
D-1	Predictability of Direct Budget Support	C+	B+	If the trend for the past two years continues, DBS disbursements will have been consistently above pledged amounts. If there could be improvements in the forecasting and actual timing of disbursements, a better score could be achieved in 2006.
D-2	Financial information provided by donors for budgeting and reporting on project and programme aid	D+	C+	Through a joint effort between Government and donors, led by the Task Force on off-budget spending already established, a more effective system for collecting information on planned

INDICATOR		2004 Scoring	2006 Potential Score	COMMENTS
				and executed project expenditure could be set up reasonably quickly, improving the score for this indicator.
D-3	Proportion of aid that is managed by use of national procedures	D	D	Given the existing fragmentation of aid delivery mechanisms, and the low percentage of aid delivered through DBS, it is unlikely that before 2006 more than 50% of aid can be managed using national procedures

ANNEX THREE

Sources of Information

1. Documents

- Agenda 2025
- Avaliação Conjunta do Apoio Orçamental Geral 1994-2004
- Balanço PES: Plano Económico e Social: 1º Semestre 2005
- CGE: Conta Geral do Estado 2004
- CGE: Conta Geral do Estado 2003
- CGE: Conta Geral do Estado 2002
- CGE: Conta Geral do Estado 2001
- CGE: Conta Geral do Estado 2000
- Off Budgets Study – Health Sector
- IGF Activity Plan 2005
- Implementação do PARPA através da Gestão das Despesas Públicas
- JR 2005: Assessment of OGE and PES [DRAFT]
- MOU: Memorando de Entendimento GoM e PAPs
- Orçamento Geral do Estado (OGE) 2006
- Orçamento Geral do Estado (OGE) 2005
- Orçamento Geral do Estado (OGE) 2004
- Orçamento Geral do Estado (OGE) 2002
- Orçamento Geral do Estado (OGE) 2001
- Orçamento Geral do Estado (OGE) 2000
- PAF/QAD: Quadro de Avaliação do Desempenho
- Parecer do TA sobre a CGE 2004
- Parecer do TA sobre a CGE 2003
- Parecer do TA sobre a CGE 2002
- PARPA I
- PARPA II - Informações dos Grupos de Trabalho
- Pesquisa Nacional Corrupção e Governação em Moçambique

- PFM Assessment 2004 Mozambique (Fiduciary Risk)
- Plano Quinquenal do Governo 2000-2004
- Political Economy of the Budget in Mozambique
- Programa do Governo 2005-2009
- Relatório de Actividades do SCI: Subsistema de Controle Interno
- Relatórios de Execução do Orçamento de Estado: 2000 – 2005
- Relatório do Estudo Off-Budgets no Sector Saude (2005)
- Relatório de Síntese: Orçamentação por Programas
- Revisão Anual - Joint Review - Aide Memoire 2005
- Revisão Semestral - Aide Memoire 2004
- Revisão Semestral - Aide Memoire 2004
- Revisão Semestral - Aide Memoire 2005
- Revisão Semestral - Aide Memoire 2005
- SISTAFE Quality Assurance Group Report
- Update Assessments and Implementation of Actions Plans of HIPC

2. Legislation

- **Decree n.º 23/2004 of 20 August: Approves the Regulation of the State Financial Administration System – SISTAFE, and revokes Decree n.º 17/2002 of 27 June**

In Boletim da República, I Serie, Number 33 of 20 August 2004

- **Decree n.º 17/2002 of 27 June: Approves the Regulation of the State Financial Administration System – Repealed**

In Boletim da República, I Serie, Number 26 of 27 June 2002

- **Law n.º 9/2002 of 13 February: Creates the State Financial Administration System (SISTAFE)**

In Boletim da República, I Serie, Number 7 of 13 February 2002

- **SISTAFE Procedures 2003/2004**

UTRAFE

- **SISTAFE Conceptual Model**

UTRAFE

- **2004 Constitution**

In Boletim da República, I Serie, Number 51 of 22 December 2004

- **Law n.º 6/2004 of 17 June: Introduces complementary mechanisms for the fight against corruption**

In Boletim da República, I Serie, Number 51 of 17 June 2004

- **Decree n.º 30/2001 of 15 October: Approves the Working Rules for Public Administration Services and revokes Decree n.º 36/89 of 27 November**

In Boletim da República, I Serie, Number 41 of 15 October 2001

- **Law n.º 4/90 of 26 September: Establishes the rules of conduct, obligations and rights of top State managers (dirigentes superiores)**

In Boletim da República, I Serie, Number 39 of 26 September 1990

- **Law n.º 7/98 of 15 June: Establishes the rules of conduct applicable to those occupying Government positions, with details of their obligations and rights, recognizing the special requirements of their work**

In Boletim da República, I Serie, Number 23 of 15 June 1990

- **Decree n.º 4/81 of 10 June: Approves the Rules of Management and Administration of the State (Aparelho Estatal Central)**

In Boletim da República, I Serie, Number 23 of 10 June 1981

- **Decree n.º 42/89 of 28 December: Approves the regulation of the acquisition of goods and the requisition of services for State organs and subordinate institutions**

In Boletim da República, I Serie, Number 52 of 28 December 1989

- **Decree n.º 29/97 of 23 September: Introduces changes to Decree n.º 42/89 of 28 December**

In Boletim da República, I Serie, Number 38 of 23 September 1997

- **Draft Procurement Law: Regulation of Procedures to be adopted on Procurement and Public Works Contracts and for the supply of goods and services**

UTRAFE

- **Law n.º 5/92 of 6 May: Approves the Organic Statute of the Administrative Court**

In Boletim da República, I Serie, Number 19 of 6 May 1992

- **Law n.º 13/97 of 10 July: Establishes the legal regime for public expenditure oversight**

In Boletim da República, I Serie, Number 28 of 10 July 1997

- **Law n.º 16/97 of 10 July: Approves the Regulation for the organization, function and procedures of the 3rd Section of the Administrative Court**

In Boletim da República, I Serie, Number 28 of 10 July 1997

- **Law n.º 10/2001 of 7 July: Defines the powers, organization, structure and function of the Customs Courts**

In Boletim da República, I Serie, Number 27 of 7 July 2001

3. Interviews

- | | | |
|-----------------------------|----------------------------|-------------|
| ▪ Aboobaar Changa | Director | URTI |
| ▪ Adelino da Cruz | Director | UTRESP |
| ▪ Agnélio Pita | Técnico | MPD – DCI |
| ▪ Amade Assane | Director Nacional Adjunto | MF – DNCP |
| ▪ Amade Azize | Director Nacional | MF – DNIA |
| ▪ Amélia Mutemba | Técnico | MF – DNT |
| ▪ Angelina Monjane | Técnico | MISAU – DAG |
| ▪ António Barros dos Santos | Director Nacional | MF – DGA |
| ▪ António Laice | Director Nacional | MF – DNT |
| ▪ Domingos Lambo | Director Nacional | MF – DNO |
| ▪ António Pinto de Abreu | Director | BdM |
| ▪ Argentina Mause | Directora Nacional Adjunta | MPD – DIC |
| ▪ Boavida Mutomsno | Técnico | MF – DGA |
| ▪ Carlos Jessen | Director | UTRAFE |
| ▪ Carolina Goenha | Directora Nacional | MF – DNCP |

▪ Carsten Sandhop	KfW	PFM Working Group
▪ Debora Marignani	European Commission	PFM Working Group
▪ Eusébio Saíde	Director Nacional	MF – DNPE
▪ Francisco Xavier	Técnico	MF – DNO
▪ Greg Binkert	World Bank	Troika Plus Economist
▪ Henrique Gamito	Assessor do Ministro	MF
▪ Isaltina Lucas	Directora Nacional Adjunta	MF – DNT
▪ Jolke Oppewal	Dutch Embassy	PFM Working Group
▪ Jorge Marcelino	Inspector-Geral das Finanças	MF – IGF
▪ Karin-Anette Andersson	SIDA	Troika Plus Economist
▪ Leonardo Novele	Técnico	IGEPE
▪ Manuel Mabumo	Inspector-Geral Adjunto	MF – IGF
▪ Maria Iolanda Wane	Directora	IGEPE
▪ Natércia Lino	Técnico	MF – IGF
▪ Nemané Junusso	Técnico	MF – IGF
▪ Pedro Biche	Técnico	MAE – IG
▪ Momad Pieraly	National Director	MPD – DNP
▪ Silvestre Panza	Técnico	MF – IGF
▪ José Sulemane	National Director	MPD – DNEAP
▪ Sylvie Millot	European Commission	PFM Working Group
▪ Telma Loforte	Swiss Dev. Cooperation	PFM Working Group
▪ Venâncio Manjate	Técnico	MAE – IG
▪ Verónica Massingue	Técnico	MF – DNCP
▪ Wim Ulens	Belgium	PFM Working Group

ANNEX FOUR

Data tables

Indicator PI-2. Composition of expenditure out-turn compared to original approved budget

Administrative Unit	2002			2003			2004		
	Budget Mt^3	Actual Mt^3	Variance [%] abs	Budget Mt^3	Actual Mt^3	Variance [%] abs	Budget Mt^3	Actual Mt^3	Variance [%] abs
Presidência da República	151,701	217,781	43.6%	211,722	262,606	24.0%	265,159	334,907	26.3%
Casa Militar	100,300	100,085	0.2%	111,296	104,125	6.4%	135,240	131,890	2.5%
Assembleia da República	171,019	189,431	10.8%	193,477	186,236	3.7%	219,709	233,033	6.1%
Ministério da Defesa Nacional	125,431	138,289	10.3%	146,675	147,531	0.6%	180,747	168,286	6.9%
Forças Armadas de Defesa de Moçambique	662,317	671,192	1.3%	740,581	703,999	4.9%	886,659	858,696	3.2%
Ministério do Interior	1,167,701	1,215,083	4.1%	1,379,505	1,311,228	4.9%	1,581,475	1,639,871	3.7%
Serviço de Informação e Segurança do Estado	182,146	192,525	5.7%	206,573	202,694	1.9%	248,940	251,250	0.9%
Ministério dos Negócios Estrangeiros e Cooperação	109,717	115,378	5.2%	130,117	218,880	68.2%	154,719	222,660	43.9%
Embaixadas e Outras Representações Diplomáticas	475,500	485,295	2.1%	534,320	504,745	5.5%	526,075	533,382	1.4%
Ministério do Plano e Finanças	115,638	175,270	51.6%	205,601	154,464	24.9%	271,598	339,085	24.8%
Alfândegas	184,516	246,899	33.8%	336,215	316,492	5.9%	395,858	423,657	7.0%
Direcção Provincial do Plano e Finanças	99,111	201,474	103.3%	201,872	230,336	14.1%	218,436	264,301	21.0%
Ministério da Agricultura e Desenvolvimento Rural	130,696	159,663	22.2%	206,145	287,705	39.6%	253,916	188,519	25.8%
Direcção Provincial de Agricultura e Desenvolvimento Rural	140,790	137,665	2.2%	186,871	138,303	26.0%	231,922	186,889	19.4%
Ministério da Educação	418,324	237,544	43.2%	436,522	286,259	34.4%	422,853	275,146	34.9%
Direcção Provincial da Educação	2,519,284	2,614,542	3.8%	3,010,265	3,197,841	6.2%	3,885,989	3,950,493	1.7%
Ministério da Saúde	718,324	508,670	29.2%	904,489	469,531	48.1%	875,759	623,047	28.9%
Hospital Central do Maputo	119,975	125,894	4.9%	168,095	139,527	17.0%	186,996	176,177	5.8%
Direcção Provincial da Saúde	738,124	711,833	3.6%	907,573	549,740	39.4%	1,067,151	937,996	12.1%
Other Expenses	7,618,959	7,132,825	6.4%	9,032,886	7,729,002	14.4%	9,822,674	9,278,185	5.5%
Variance in Total Expenditure	15,949,573	15,577,338	2.3%	19,250,800	17,141,244	11.0%	21,831,875	21,017,470	3.7%
Variance in Composition	15,949,573	15,577,338	9.0%	19,250,800	17,141,244	15.5%	21,831,875	21,017,470	7.6%
Excess Variance (due to variance in composition)			6.7%			4.6%			3.9%

Source: Government of Mozambique, OE and CGE 2002, 2003 and 2004

