The PFM Handbook

How to Assess Public Financial Management (PFM) in Developing Countries

February 2014

Japan International Cooperation Agency

Industrial Development and Public Policy Department

Preamble

In recent years, there has been increasing awareness within the international development community of the importance of public financial management (PFM) in developing countries. Behind this, there is a recognition that fiscal management stability and sustainability are necessary to achieve the Millennium Development Goals (MDGs) and other development goals set forth in the national development policy of the developing country. To this end, ensuring the three principles, i.e., aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery, is necessary, and PFM is the necessary institutional framework. The Fourth High Level Forum on Aid Effectiveness (HLF-4, November 29 to December 1, 2011) in Busan, Korea, brought even greater recognition of the importance of a strong PFM system for effective and efficient use of aid. Additionally, in January 2013, the Public Expenditure and Financial Accountability (PEFA) Program, a multi-donor partnership by seven bilateral and multilateral donors including the World Bank, produced a Good Practice Note on Sequencing PFM Reforms that has brought a fresh dimension to the work on assessing the PFM reform process.

In February 2013, the Japan International Cooperation Agency (JICA) developed thematic guidelines and a position paper on PFM. These documents stated that PFM reform is: “a major reform process with the potential to affect the entire public sector. PFM reforms constitute a key development issue that has ramifications for everything from the formulation of a blueprint for reform to the details of its execution, and from development planning to new paradigms for public sector management in the country in question.” “In providing assistance to address the development challenges faced by developing countries, JICA views PFM as one of the key institutional arrangements to be established and strengthened in all sectors and programs/projects.”

As these two documents state, JICA staff and experts, who are engaged in its development cooperation activities, should be keen to PFM system in the partner country regardless of their level of understanding and experience of PFM in general. If possible, they should be able to see whether or not PFM institutional arrangements in the recipient countries are good. In the case of PFM assistance, when they formulate and design programs and projects, they should do so from the medium- and long-term perspectives. They should not pursue tangible outputs and outcomes in the short term. In the case of non-PFM assistance, we may face problems that would affect the smooth implementation of JICA projects and the sustainability of the outputs and outcomes of those projects. Good or bad, they may consider simply how the PFM system should be changed only for the benefit of JICA projects and programs. However, primarily they should consider how the PFM system should be in the country from a neutral and well-balanced position.

However, assessments of PFM reform progress in a particular country are daunting tasks for many people. They require both background knowledge and experience of PFM. Against this background situation, JICA has developed this Handbook with a view to assisting its staff and experts to become familiar with PFM system performance measurement. This Handbook is intended to offer some practical guidance for future assessments in this area. It will be revised as JICA accumulates more experience in PFM and discrepancies in the Handbook come to light.

We would like to acknowledge the many useful opinions and comments received from all those involved in this work. Special mention should be made of Prof. Shinji Asanuma (Visiting Professor, School of International and Public Policy, Hitotsubashi University), Prof. Hisanobu Shishido (Professor, Department of Economics, Tokyo Woman's Christian University), and Prof. Hideaki Tanaka (Professor, Graduate School of Governance Studies, Meiji University) who made valuable contributions to the JICA Working Committee on PFM, to all the JICA project stakeholders who supplied comments and diagrams, and all those who participated in internal PFM working group meetings here at JICA (specifically, members of the Southeast Asia and Pacific Department, South Asia Department, Latin America and the Caribbean Department, Africa Department, Middle East and Europe Department, Financial Cooperation Implementation Department, Credit Risk Analysis and Environmental Review Department, Loan and Administration Department, and the Evaluation Department) for their work on this project study. Special thanks in particular should be made to Taichi Sakano (Senior Researcher, Department of International Studies, Mitsubishi UFJ Research and Consulting Co. Ltd.) who played a prominent role in the writing of this Handbook as an outsourcing consultant of this project study.

February 2014

Takumi Ueshima,
Director General
Industrial Development and Public Policy Department
Japan International Cooperation Agency (JICA)

Contents

User Guide

PFM is essential to address the development challenges faced by the developing countries. All of us should bear in mind PFM in our development cooperation activities. All of us should cultivate an “eye” for seeing PFM. However, there may be few people who will have the time to read through this Handbook. For those readers, we suggest going through the necessary parts according to the following guide. At the very least, be sure to read Chapters 2 and 3, as they are indispensible to any assessment of PFM system performance.

Application scenario 1: You need to understand the mechanisms that are giving rise to PFM-related problems in the implementation of development cooperation projects.

- At project identification/formation and appraisal: Start by reading sections 4-3, 4-4, 4-5, 4-6, 4-7, 4-8, and 4-16 of Chapter 4 to brief yourself on budget allocation decisions and budgetary outlooks as upstream processes in the PFM cycle. Next, read sections 4-9, 4-10, and 4-17 on treasury management and sections 4-13 and 4-14 on budget execution to understand what problems are likely to occur in service delivery with the implementing agency in the recipient country.
- At project implementation: The failure of the implementing agency in the recipient country to disburse funds as initially agreed is a frequent problem at this stage of the project cycle; thus, you should start by reading sections 4-9, 4-10, and 4-17 of Chapter 4 on treasury management to get an understanding of whether or not the recipient government has the mechanisms in place to facilitate the smooth flow of funds. Next, read sections 4-3, 4-4, 4-5, 4-6, 4-7, 4-8, and 4-16 on budget preparation and sections 4-13 and 4-14 on budget execution to understand the upstream stages of the PFM cycle.
- At other common stages: Sections 4-15, 4-16, and 4-18 on internal and external audits should offer some important insights on PFM during each of the phases of the project cycle given above.

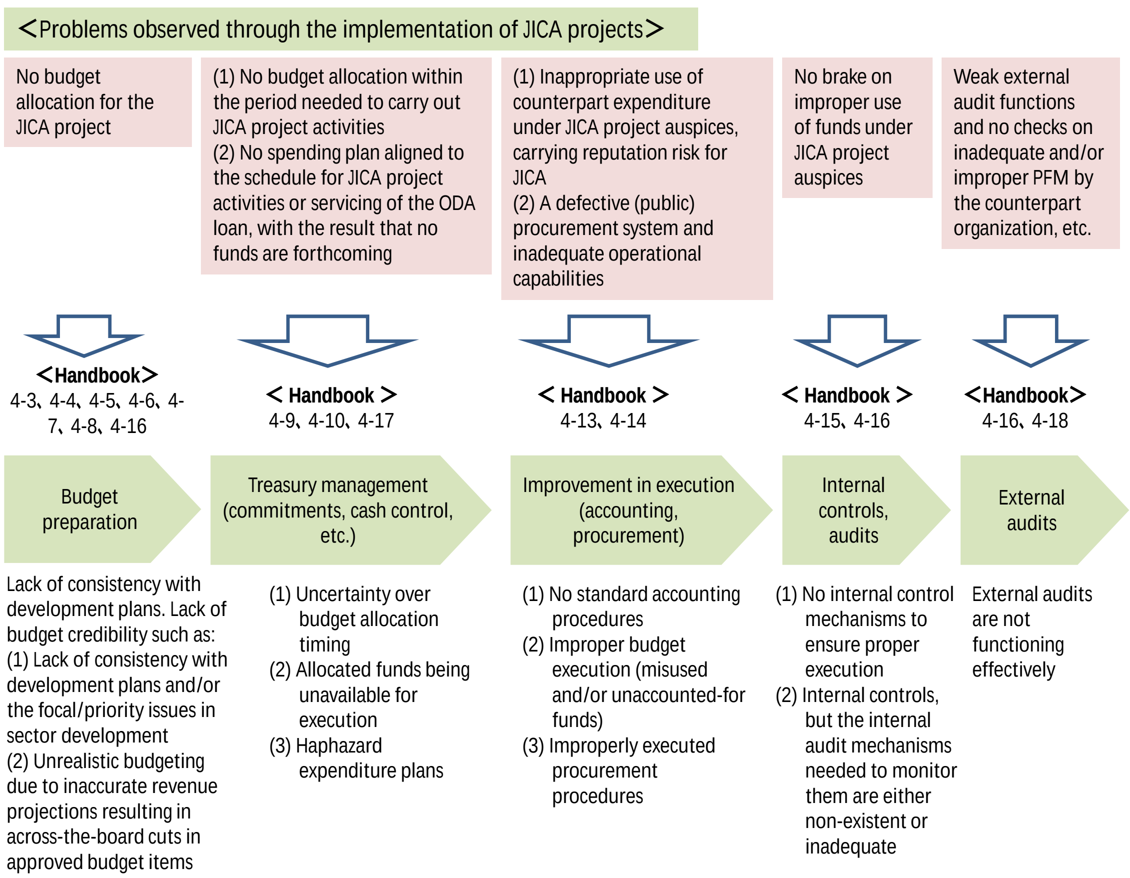
Application scenario 2: You need to get a general idea of progress in PFM reforms in the recipient country.

STEP 1: Where a PFM Performance Report is available, start by rating progress towards PFM reforms in the recipient country by PFM function, using the “Matrix for Measuring Progress in PFM Reforms” in Appendix 1 as a guide.
STEP 2: Read the relevant sections of Chapter 4.
STEP 3: Assess progress in PFM reforms in the recipient country using “3-3. Sequencing PFM Reforms” in Chapter 3 as a guide.

Application scenario 3: Multiple donor agencies are to present a joint roadmap for PFM reforms to the recipient government. Prior to this, you need to know the basic reform priorities in order to generate a viable reform path. You also need to understand the significance of the reform agendas being pushed by other donor agencies.

<u>STEP 1</u>: Where a PFM Performance Report is available, start by rating progress towards PFM reforms in the recipient country by PFM function, using the “Matrix for Measuring Progress in PFM Reforms” in Appendix 1 as a guide.
<u>STEP 2</u>: Clarify which of the performance indicators given in Appendix 1 corresponds to the PFM reform proposals being pushed by other donors. Also read the relevant sections of Chapter 4.
<u>STEP 3</u>: Assess progress in PFM reforms in the recipient country using “3-3. Sequencing PFM Reforms” in Chapter 3 as a guide.

Figure 1: User Guide



Part I. Introduction

Chapter 1. Background and Objectives

1-1. Background

Since the late 1990s, there has been a widespread recognition in the international development community of the importance of PFM as a development issue. This can be attributed to a number of trends, for example: (1) the Poverty Reduction Strategy Paper (PRSP) should have more links with public expenditure in the PRSP era; (2) both donor and developing countries recognize the importance of more effective and efficient use of aid in the circumstances of an “aid-fatigued” atmosphere and the limited prospects for a substantial increase in funding and among donors; (3) as the concept of aid fungibility has taken hold, there has been a growing awareness among donor agencies of the need to monitor the PFM of a developing country as a whole in order that aid funding can be used to generate other development outcomes in addition to general budget support; and (4) as interest in the use of country systems (for aid delivery) has grown on the tide of the Paris Declaration on Aid Effectiveness, there has been a commensurate increase in the levels of interest in reliable PFM systems in developing countries.

In response to these developments, in February 2013, JICA developed thematic guidelines on “Public Financial Management,” and outlined the scope and functions of PFM that JICA should address from now on. At the same time, JICA also developed the PFM Position Paper, which clarifies its position on PFM and defines the direction of future assistance in this area by affirming that: (1) efforts will be made to achieve a more strategic delivery of assistance to PFM as one of the development issues, and (2) efforts to integrate the PFM perspective into the PDCA (plan–do–check–act) cycle of JICA projects will be stepped up.

The PFM Position Paper provides only general statements on this issue, and there are a number of gaps that need to be filled if its objectives are to be attained in the field. For example, as for (1) above, the position paper emphasizes the importance of addressing PFM issues more strategically. However, it does not describe the general situation of the current state and characteristics of PFM systems in the recipient country. It also does not describe either a method to identify needs for future JICA assistance, or a practical method of addressing PFM at each stage of the PDCA cycle of JICA projects. Again, while the PFM Position Paper calls on JICA (both Headquarters and Overseas Office personnel) to raise the PFM issue in all of its bilateral discussions with recipient governments and to exchange opinions sufficiently with other donor agencies on PFM-related issues, it does not clarify what aspects of PFM are to be discussed and what questions should be raised to ensure that discussions on PFM are effective. Moreover, while the Paper recommends that PFM be added to the scope of country analytical papers, basic studies, and program/project formation study, it does not sufficiently specify what should be analyzed in term of PFM.

In consideration of such a situation, this Handbook describes the fundamentals of PFM with a view to helping JICA staff and experts develop a capacity to assess progress in PFM reforms in aid-recipient countries.

Since the late 1980s, through the accumulation of various efforts up to the current PEFA, the basic concepts and framework have been standardized, such as: (1) the three basic principles that support fiscal management stability and sustainability (i.e., aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery); (2) what PFM is; (3) the elements of the PFM functions (i.e., budget planning, preparation and execution, reporting and monitoring, audits, etc.); and (4) how progress in PFM reform in specific countries is assessed. In this context, when JICA staff and experts participate in discussions on PFM either at the international or the partner country level, it is an important prerequisite for them to be able to discuss PFM using the same terminology and logic as colleagues from the partner country and donors.

1-2. Objectives

Potential Users

This Handbook is designed to be used mainly by both JICA staff and experts who are engaged in specific JICA projects (hereinafter referred to as "JICA staff and experts").

Objectives

This Handbook aims to accomplish the following through improving PFM literacy:

- The ability to understand progress and achievements in PFM reforms in the recipient government from a neutral and broad perspective;
- The ability to discuss PFM with the partner country and donors using the same terminology and logic; and
- The ability to build both technical perspectives (on education, health, agriculture, etc.) and PFM perspectives, and to engage these perspectives in the operation of individual JICA projects (i.e., critical policy and institutional factors which would affect implementation and the level of outputs and outcomes).

Points to Bear in Mind

- **The purpose of this Handbook:** As stated above, this Handbook has primarily been designed to assist JICA staff and experts in diagnosing progress in PFM reforms in developing countries and the strengths and weaknesses of core PFM functions. It is not intended to be used as a tool for designing PFM reform programs. The design of a PFM reform program will depend largely on the context and political motivation for PFM reforms in the recipient country. This will also depend on the institutional capacity of the relevant organizations, as well as on various factors other than technological factors. Such design cannot be determined when it is based only on the strengths and weaknesses of the PFM functions that were observed using diagnostic tools such as PEFA. Finally, users of this Handbook are strongly encouraged to always bear in mind (1) the condition under which the recipient government started PFM reforms, and (2) how the reform process is being managed in the country.

- **PFM – development issues versus risk factors which would affect JICA project implementation:** The Japanese ODA community has been enhancing its level of undertaking with regard to PFM, but it is still evolving. Therefore, this Handbook tries to discuss PFM issues from the aspect of risk factors at first, i.e., how a poor-quality PFM system in a recipient country would affect smooth operations and the achievement of project outputs and outcomes. This approach is much easier for many people to become familiar with PFM, although it is not common in the international development community. At the same time, we would like to remind you that a good PFM system that meets the expectations of donors (including JICA) does not always mean a good PFM system that is actually required in the country context. Therefore, donors should primarily consider how appropriate the PFM system should be for the partner country and try to see the current situation from a neutral position without any preconceptions. Accordingly, while the majority of readers will read this Handbook from the perspective of benefits to JICA projects, it is hoped that you will always consider how a desirable PFM system should be for the partner country and what kinds of policy measures should be taken in the PFM reform program.
- **Relationship with PEFA indicators:** Internationally, the Performance Measurement Framework was developed under the Public Expenditure and Financial Accountability (PEFA) Program in 2005. It has been used to perform some 350-plus assessments to date. PEFA developed this diagnostic tool in the early 2000s for reducing transaction costs created by multiple donor agencies when they conducted PFM diagnostic work. Accordingly, this Handbook is not intended to serve as an alternative to the PEFA assessment tool. Rather, it is designed to be used in conjunction with PEFA and other existing PFM assessment tools and studies to help JICA staff and experts gain a proper understanding of progress towards PFM reforms in developing countries. Furthermore, except under some very specific circumstances, this Handbook is not intended to advocate the aggressive promotion of a unique JICA assessment tool separately from PEFA and other similar exercises.

Reference: PEFA Performance Measurement Framework

http://www.pefa.org/en/content/pefa-framework-material-1

PEFA Assessment Portal Map: http://www.pefa.org/en/dashboard

* To view the results of specific PEFA assessments, use the mouse to position your cursor over one of the colored pins on the map and click on the colored pin to display a country pop-up window, which will provide an overview of the status of all assessments in a particular country. Links to the most recent public assessments are available in the country-specific preview window (click on "Assessment Report").

Chapter 2. The Importance of PFM knowledge and Assessment

2-1. Background

All JICA staff and experts are involved in PFM systems directly or indirectly in their work. The PFM Position Paper recognizes the following two principles in its discussion of PFM:

- Delivering PFM assistance as one of the development issues; and
- Addressing PFM issues in the operation cycle of individual projects as a risk factor that would impede the smooth implementation of JICA projects and affect the sustainability of aid effectiveness and development outcomes.

1. Delivering PFM assistance as one of the development issues

The PFM Position Paper outlines three pillars underpinning strategic assistance for PFM reforms, as follows.

Figure 2: The Three Pillars of JICA Assistance for PFM Reforms

Pillar	Abstract	Cases
Support for PFM as reform of whole governmental system	Adopt PFM issues in the policy matrix for Development Policy Loan	(i) Dispatch of policy advisors: Indonesia, Lao PDR, Cambodia, and Thailand. (ii) Yen loan and grant cooperation: Indonesia, Vietnam, the Philippines, Cambodia, Lao PDR, Tanzania, and Ghana (grant).
Support for implementing specific policy measures to reform PFM system	Support for implementing each policy measure within a PFM reform program mainly using technical cooperation tools	(i) Budget: Indonesia Planning and Budgeting Reform for the Performance-Based Budgeting (PBB) System Implementation (ii) Tax administration: Indonesia, Cambodia, Mongolia, the Philippines, Vietnam, and Tanzania (iii) Internal audit: Tanzania, Mongolia, and Ghana
Support for improving debt management and financial management of Yen loan implementing public entities	Support for improving debt management and financial management of public cooperation. This helps to secure financial sustainability of infrastructure financed by Yen loan. From a wider point of view, this contributes to improving insufficient debt management and financial management in the recipient country's public sector. This also leads to improving one of the reasons for central government fiscal deficits.	Support by Yen loan (e.g., technical assistance through Yen loan account)

As illustrated, when JICA is extending a development policy loan (DPL) or poverty reduction support credit (PRSC), JICA designs a reform agenda policy matrix together with other co-financers. PFM-related issues are usually included in the matrix. Thus, JICA staff and experts need to understand the significance of these PFM-related issues in the whole picture of the PFM reform program in the partner country. They should then be involved in the process of designing the policy matrix, and understand the final version of the matrix. In that process, an option for JICA is to propose including PFM related issues that actually affect the operation of the yen loan project.

In the case of technical cooperation, when JICA examines project requests from the partner country, it tends to examine it and design the project framework mainly from the technical perspective based on the approach proposed in the request document. However, if JICA can identify the potential risk factors from past experience, it should consider risk control measures in the project design stage, and formulate other projects for addressing those identified risks.

2. PFM as a risk factor for JICA project implementation

The PFM Position Paper calls for efforts to take possible risk control measures in each stage of the PDCA cycle for JICA projects. Published in January 2014, the thematic evaluation report on the financial sustainability of outputs and outcomes in development cooperation projects describes shortcomings impeding the financial sustainability of JICA projects, and develops a checklist for identifying risks in each stage of the PDCA cycle.

The report calls for “taking possible actions at every stage of JICA’s PDCA cycle.” However, most of the potential risk resulting from the poor quality of PFM systems constitutes a systemic issue. It is in fact no easy matter to take action and solve these problems at the individual project level in the short term.

Take the example of a failure of counterpart organizations to disburse travel expenses and other necessary funds as agreed on in a technical assistance project, thereby hampering the smooth operation of the JICA project. In such a situation, there is too great a difference between whether we just talk about these things as interesting topics during coffee breaks in the office or if we try to understand what is happening behind the problems from the PFM perspective.

Anyone with some knowledge of PFM will know the following.

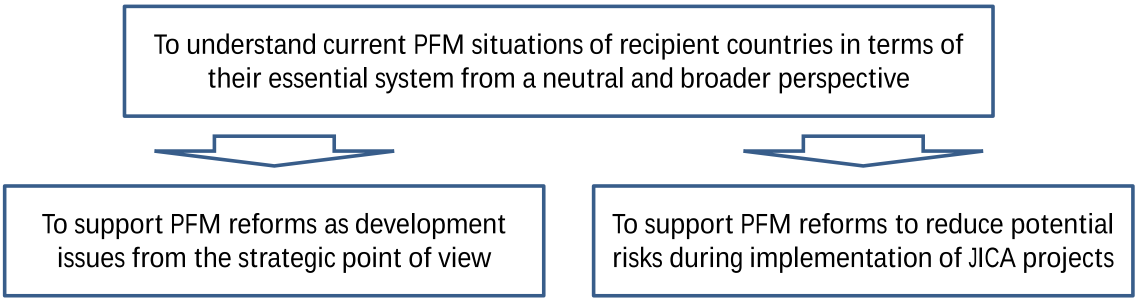
- Once the recipient government has finalized its Medium-Term Expenditure Framework (MTEF) and budget preparation work (for the subject fiscal year), it is too late to ask for money to fund a JICA project. (To prevent this, JICA staff and experts need to know the budget preparation process and the timing of budget decisions and to take appropriate actions at the right time, though it goes without saying that this does not guarantee getting a result.)
- While the counterpart organization is asked to secure funds to cover its portion of the expenses in a JICA project, it will naturally prove difficult for the organization to secure the requisite appropriation unless the project in which JICA is involved can be kept on budget. (To prevent projects from going over budget, JICA staff and experts need to manage the necessary expenses “on budget” in the partner country. Of course, there are cases in which the funds are secured and the counterpart’s portion of the expenses is covered even if the project is not on budget.)

It is hoped that readers of this Handbook are not simply bemoaning the failure of counterpart organizations to release their portion of project expenses on a timely basis without first ascertaining when the fiscal year begins and ends in the recipient country, how the budget preparation process and the timing of budget decisions work, and how these synchronize with the JICA project cycle.

2-2. Approaches to PFM Assessment

Given that the PFM system forms part of the recipient country's basic institutional framework, users of this Handbook are encouraged to start by examining the current state of the PFM system as something essential to the functioning of the recipient government so as to approach the issue from one of the two perspectives discussed in section 2.1 above.

Figure 3: Desirable approaches to PFM



In practical terms, it is possible to design a project framework to assist specific PFM functions even if we do not know the current status of the recipient country's overall PFM system. However, in the process of identifying, formulating, and designing technical assistance projects, for example, for performance-based budgets and internal audits, it is critical to understand the entire overview of the recipient country's PFM system and to clarify designated roles that are intricately intertwined with other functions, comprising the one "system" of PFM.

Again, where PFM is perceived as a potential risk factor for the implementation of a JICA project, one option could be to concentrate on the potential risks and take risk control measures. However, we need to recognize that profound PFM-related problems are just the tip of the iceberg, and deep problems exist below the surface. Problems regarding PFM functions are intricately intertwined with each other. Thus, it is desirable to look at the fundamental background of these problems before concentrating on specific issues. Even if you assume that you have identified PFM-related causes, you need to carefully examine: (1) whether this is a systemic issue; (2) if so, whether the current situation should be accepted or reformed for the recipient country's ideal PFM system; and (3) if a need for reform is identified, whether it can be improved in the short term. While the existing PFM system may not be welcomed for the JICA project in question, it may well be entirely justifiable in the context of the recipient country's ideal PFM system. You may accept the current situation or reject it. This is an issue for your "balance," for example, between PFM for the partner country and

PFM for the operation of the individual aid project. To manage this properly, you are required to have an “eye” to see the PFM system of the partner country from neutral and holistic perspectives.

2-3. Improving PFM Literacy

With this in mind, JICA staff and experts are encouraged to read this Handbook and ultimately to improve their PFM literacy as follows.

Recommendations for Improving Your PFM Literacy

1. You will become aware that PFM reform is a process that will affect the public sector as a whole. Consequently, it is linked with the blueprint for the entire reform process and its implementation. It also has a close relation with development planning and public sector management.
2. As someone involved in development cooperation, you will become aware of the negative effects of ignoring the PFM issue.
3. You will foster an “eye” to assess PFM in terms of the following:
   (1) An “eye” to see progress in PFM reforms; and
   (2) An “eye” to see the current status of individual PFM functions.

As stated above, this Handbook hopes that you do not just talk about PFM-related issues as interesting topics during coffee breaks in the office, but that you try to understand the background of PFM-related bottlenecks and take action against these risks.

Part II. An "Eye" to Assess PFM

POINTS

When you read this chapter, you can build a basic foundation necessary to discuss PFM with the partner country government and donors using same wording and the same logic, and you can understand the PFM aspect of the development process and activities in the partner country along with technical aspects such as education and health. You can consider development processes and activities from a wider angle.

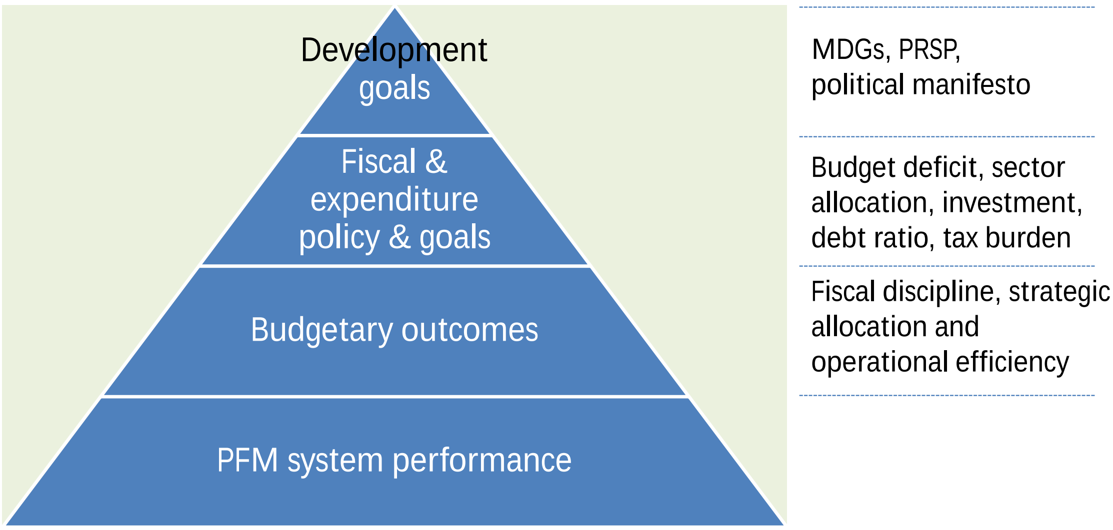
Chapter 3. Acquiring a Proper, Balanced Understanding of PFM: The Basics

3-1. What is PFM?

PFM reform will have major consequences for the public sector as a whole, and these consequences need to be seen as a key development issue that will have wide-ranging ramifications, from the formulation of a blueprint for reform to the details of its execution. These ramifications will also impact development planning and public sector management in the country in question.[1]

In order to gain a proper and balanced understanding of PFM, it is important to understand its relationship to development goals (e.g., the MDGs and other development goals set forth in national development policy) and the interim targets that have been established to facilitate the achievement of high-level fiscal management objectives (i.e., stable and sustainable fiscal management).

Figure 4: A Triangular Representation of PFM Links to Development Goals, High-Level Fiscal Management Objectives, and Interim Targets



Source: PEFA presentation materials (accessed December 2013)

Under normal circumstances, all countries map out basic policies and national development plans, which will include the development goals that the country is working towards. Ensuring fiscal management stability and sustainability is one of the factors that enable governments to achieve their development goals. To deliver on this goal, it is necessary to adhere to the following three principles.

The Three Principles

- **Aggregate fiscal discipline:** Maintaining fiscal discipline over total expenditure on the basis of explicit and enforceable decisions and based on realistic revenue projections and sustainable debt levels.
- **Strategic allocation of resources (allocation efficiency):** The most strategic allocation of

[1] Excerpted from Thematic Guidelines on Financial Administration and Public Financial Management, February 2013 (JICA 2013a).

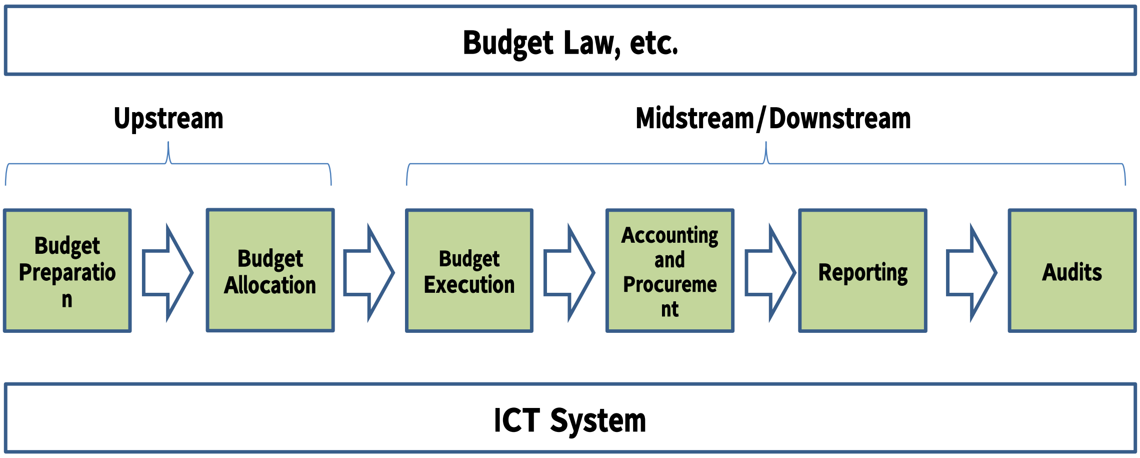
resources given government priorities and project outcomes.

- **Efficient service delivery (operational efficiency):** Execution of the budget without duplication or waste and the delivery of efficient services.

The PFM system exists to ensure that these three principles are adhered to.

PFM systems are composed of upstream, midstream, and downstream processes that include the functions given in Figure 5 below. It is important to obtain a holistic understanding of the overall PFM system and its individual functions, as well as the problems that might occur in developing countries if these functions are not effectively working. In such cases, it is also important to take into account the links between PFM system performance and development goals, high-level fiscal management objectives, and the interim targets illustrated in Figure 4.

Figure 5: Upstream, Midstream, and Downstream PFM processes



The international development community is getting closer to reaching a consensus on PFM-related issues. Accordingly, it is important for JICA staff and experts to bear in mind the triangular structure shown above, the three principles (i.e., aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery), and the upstream, midstream and downstream PFM processes when they participate in discussions on PFM and read the relevant literature. You are encouraged to gather the intelligence you need on the subject from the seemingly disorderly profusion of information that is available.

Figure 6: Core PFM Functions

Classification	Contents
Laws and regulations	Budget law
Budget planning	Macroeconomic forecasting, revenue forecasting, and Public Expenditure Review (PER)
Budget preparation	Budget preparation method (line-item budget and performance budget), Medium Term Expenditure Framework (MTEF), budget preparation process, public investment plan) etc.
Revenue	Tax system and tax administration
Budget execution	Treasury management (cash management, cash planning, and debt management)
Accounting and procurement	Accounting rules and procedures, and public procurement system
Audit	Internal audit and external audit
Reporting	Financial report and final account
IT system	A series of PFM sub-components (budget preparation, execution, settlement of final accounts, tax administration, and custom administration, etc.) is integrated into a system. This system is operated with a certain user interface.

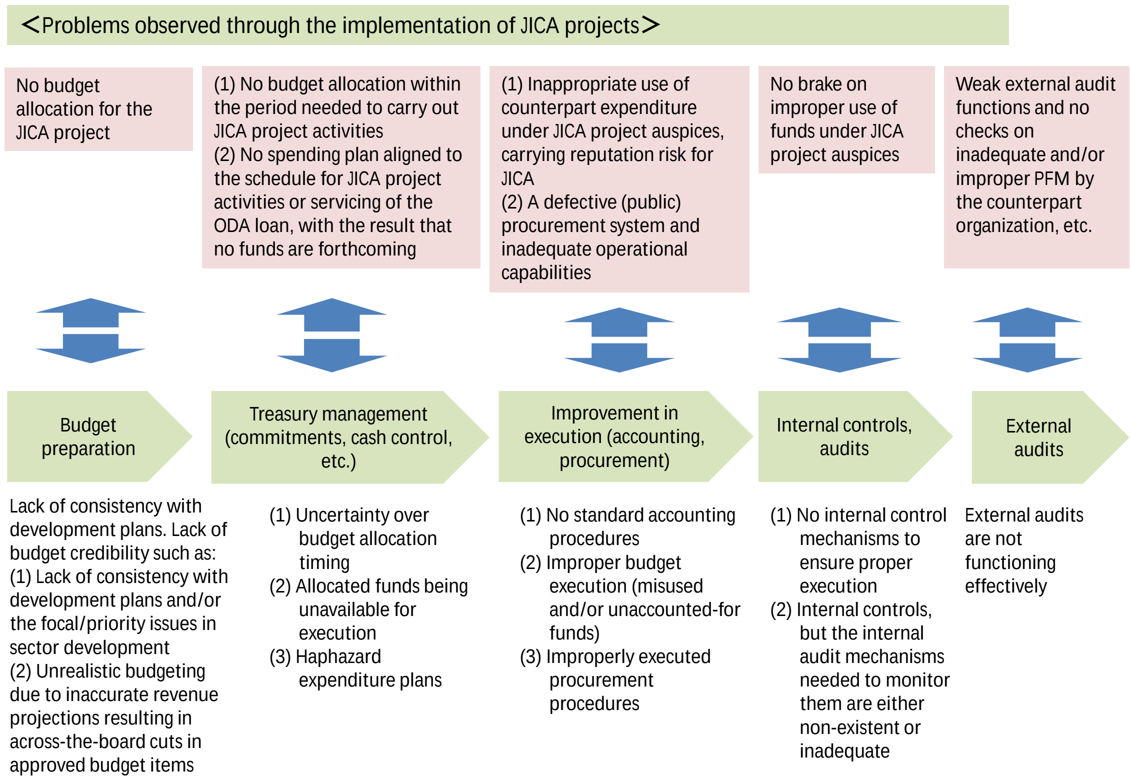
3-2. Is it Necessary to Know all the PFM Functions?

The tendency to view PFM solely in terms of its risk to JICA project implementation requires caution from two perspectives. Firstly, readers of this Handbook may fail to distinguish between a PFM system advantageous to JICA projects and an ideal PFM system for the recipient country, which contributes to confusion regarding the sequencing of PFM reforms. Secondly, it may be tempting to think that you only need to familiarize yourself with those PFM functions that pose a direct risk to JICA project implementation, and thus that it is safe to ignore other functions.

The following are examples of potential risks to the implementation of JICA projects, whether in the form of ODA loans, grant assistance, or technical assistance. However, it is easy to see why some readers might be tempted to think that simply understanding these aspects of the PFM system, which have a direct link to JICA project implementation, is sufficient to the task.

- The necessary budget for the JICA project has not been allocated.
- The appropriations are not allocated at the time necessary for JICA project activities.
- No spending plan corresponding to the schedule of JICA project activities and ODA loan repayments has been drafted, and the requisite funds are not forthcoming as a result.
- Budgetary funds allocated to cover counterpart expenses are being spent inappropriately in the name of JICA project activities, creating reputation risk for JICA.
- The public procurement system is defective and poorly operated, leaving the recipient government unable to procure adequate funding.
- Misuse of funds in the name of JICA project activities is unchecked.
- The external audit function is poor, and inappropriate and improper PFM on the part of counterpart organizations of the JICA project is inevitable.

Figure 7: Problems Observed in JICA Project Implementation and the Corresponding PFM Functions



A realistic approach to major human resource and time constraints could be to focus on immediate needs and to undertake a current state analysis of the relevant PFM functions. However, since all the functions are connected to a greater or lesser extent, up to a point it will be necessary to assess the PFM system in its entirety.

Where, for example, problems relating to the "downstream" functions of PFM hinder the smooth implementation of a JICA project, the further downstream in the PFM cycle you move, the more it will be necessary to understand the current state of upstream processes. If the budget for counterpart expenses has not been executed, it will be necessary not only to establish whether or not the allocation of appropriations process is functioning properly, but also to look at the earlier stages in the budget cycle, i.e., the budget preparation processes, to determine whether the counterpart organization has in fact put in the relevant budget request. By contrast, if the problems are related to upstream PFM processes and there are no functions any further upstream, it would be inadvisable to limit your assessment to midstream processes at the neglect of those further downstream in the PFM cycle. As Figure 4 illustrates, given that PFM system performance is ultimately the platform that enables governments to achieve their development goals, it is undesirable to disregard the current status of the downstream PFM functions that are necessary to (realize) efficient service delivery.

Again, no individual PFM function is independent of other functions; the functions all form part of an integrated PFM system. For example, a poorly functioning internal audit system may be admissible insofar as the external audit system functions effectively, thereby complementing internal audit functions and ensuring the financial accountability of government. The goal of PFM reforms is not to have all countries achieving an aggregate PEFA score equivalent to an (A), which is the ultimate and most difficult challenge; rather, it is important to look at the PFM systems of individual countries with a view to establishing how the respective functions fit together and whether the system facilitates the necessary functioning of these individual processes.

Insofar as there are no such constraints, readers are encouraged to use this Handbook to acquire a broad-based understanding of PFM such that they are able to assess the current status of PFM performance across the entire system in the recipient country, rather than viewing it simply in terms of potential risk factors for a specific JICA project.

3-3. Sequencing PFM Reforms

Before you can begin to assess PFM system performance, it is necessary to get to grips with the discussions on the sequencing of PFM reforms.

There has been a surge in interest in this topic in the international donor community in recent years. This heightened interest in a sequenced approach to reform first emerged in the late 1980s as donors began questioning whether their assistance for PFM reforms was actually producing results. Allen Schick's contribution, which stresses the important principle of "getting the basics right" as a first priority when undertaking reform, is a representative example of the literature on PFM sequencing. Simply put, the systems, frameworks, and knowledge used in PFM functions are of two types: basic knowledge and skill, and applied knowledge and skill. Schick argues for an incremental approach. The more complex and advanced the reform agenda is, the more you should initially focus on the establishment of basic systems and frameworks and on the utilization of basic knowledge and skill. Once the groundwork is completed, you can then move toward a stage that is more complex, utilizing advanced knowledge and skill.

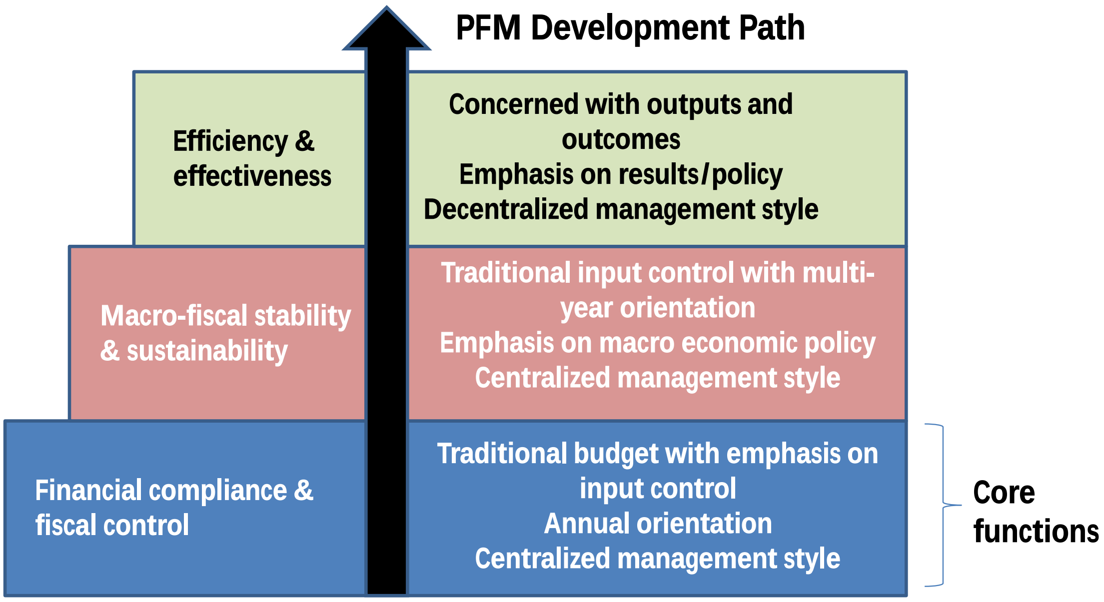
Allen Schick's "Getting the Basics Right" Approach

- Foster an environment that supports and demands performance before introducing performance or outcome budgeting.
- Control inputs before seeking to control outputs.
- Account for cash before accounting for accruals.
- Establish external controls before introducing internal control.
- Establish internal control before introducing managerial accountability.
- Operate a reliable accounting system before installing an integrated financial management system.
- Budget for work to be done before budgeting for results to be achieved.
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector.
- Have effective financial auditing before moving to performance auditing.
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them.

Source: *Public Expenditure Management Handbook* (World Bank 1998).

In January 2013, PEFA completed the Good Practice Note on Sequencing PFM Reforms (GPN). The GPN argues that the order of reform actions should follow a hierarchy determined by the three main deliverables of a well-functioning PFM system, which are, in order, management systems to ensure (1) financial compliance and fiscal control, (2) macro-fiscal stability and sustainability, and (3) efficiency and effectiveness. While all three deliverables are equally important, the GPN argues that the PFM functions necessary for securing financial compliance and fiscal control are "core" functions and thus that establishing these should be the leading priority for reform.

Fig. 8: Sequencing PFM Reforms



Source: PEFA Good Practice Note on Sequencing PFM Reforms, January 2013 (Diamond 2013).

Figure 9: Core PFM Functions

Core Function 1: Realistic budgeting **OUTCOME: Budget outturn is close to budget approved ex ante**
Ø Revenue forecasts are realistic, based on detailed analysis of revenue bases and macro-economic developments. Ø Expenditures are fully costed, with adequate allowance for inflation and exchange rate movements.
Core Function 2: In-year control over spending **OUTCOME: Budget outturn avoids overruns and arrears**
Ø Tax administration has the capacity to enforce tax laws. Ø Continual analysis and follow-up of revenue collection versus estimates.
Core Function: Timely accounting and reporting **OUTCOME: Budget execution performance is known throughout the year allowing for adjustment if required**
Ø Accounting is comprehensive and timely. Ø Reliable and timely bank reconciliation is in place. Ø Reports can be produced with minimal delay so that budget execution can be tracked and the public sector monitored.
Core Function: Central control over cash **OUTCOME: Budget minimizes the use of cash and risks of financial irregularity**
Ø Central control over cash. Ø Use of a Treasury Single Account (or consolidated fund concept). Ø Minimize the number of bank accounts and cash transactions.
Core Function: Adequate internal control procedures **OUTCOME: Budget execution avoids rent-seeking behavior and financial irregularities**
Ø Administrative internal controls in place in all government departments. Ø Procurement is transparent with well-defined regulations. Ø Internal audit functions adequately.
Core Function: Adequate external control procedures **OUTCOME: Transparency and financial discipline enforced**
Ø External audit addresses financial irregularities with timely reports to the legislature. Ø Strong legislative scrutiny and follow-up on audit reports.

Source: PEFA Good Practice Note on Sequencing PFM Reforms (Diamond 2013).

What is meant by donor common sense?

The point to remember here is how donors need to adapt the design of their reform agendas so that the PFM development path corresponds to progress in PFM reforms and other circumstances in the recipient country.

The PEFA GPN contends that the success or failure of a PFM reform program is largely affected by country-specific circumstances and non-technological factors in addition to the relevant technical considerations. Accordingly, donors should avoid assessing the current status of PFM reforms in the recipient country when providing advice on PFM sequencing decisions; **in terms of fostering a capacity to assess PFM, however, there is a need to bear in mind the discussions on PFM reform sequencing. For example, any reader participating in a government-donor working group on PFM reform design for a recipient country is likely to hear various terms in**

connection with the budget preparation process, including “MTEF,” “program budgeting,” and “performance budget.” However, from a sequencing perspective, donors should avoid proposals advocating the introduction of these budget systems before the traditional budget with input control has been successfully implemented based on the annual orientation. In the case of proposals, the details should be realistic and attainable.

When discussing or making proposals on PFM issues, readers are encouraged to avoid being swayed by changing concepts and to explore what they want to say first in terms of PFM reform sequencing and other dimensions before making statements or committing their thoughts to paper. Regarding the issue of donor common sense, readers should avoid proposals for reforms that would be difficult to achieve even in an advanced economy.

Chapter 4. An Overview of PFM Functions

A PFM system comprises numerous functions. This chapter aims to elucidate the basic concepts underpinning each of the PFM functions. It also aims to highlight the issues of developing countries where these functions are failing, the impacts on JICA projects, and the points to look for when assessing progress in PFM reforms.

To help readers familiarize themselves with PFM, each section contains highlighted passages that indicate relevance to JICA project implementation. As was pointed out in the section entitled "Points to Bear in Mind" under "Potential Users" (Chapter 1-2), however, readers should avoid focusing exclusively on these passages since it is important to remember that a PFM system that is advantageous to JICA projects does not necessarily correspond to a PFM system that works best for the recipient country.

4-1. Leadership and Motivation of PFM Reform in the Country

The exercise of leadership over a PFM reform program, a government's commitment to it, and the sustainability of the reform process and its outcomes are determined by whether the motivation for such reforms comes from within the country or is imposed from outside.

In countries with a working PFM reform program, the primary task is to establish what agenda has been set for reform. The next step is to determine who is leading the reform process and what the reforms are motivated by. The PEFA GPN discussed above argues that the success of PFM reform initiatives is largely dependent on country-specific situations and non-technological factors (e.g., the political-economic environment in which policymakers are required to make decisions, the mood of both the nations and institutions accepting reforms, the capacity level to implement reforms, etc.), in addition to technical considerations regarding PFM functions.

4-2. Legal and Institutional Budgetary Frameworks

At the foot of the PFM ladder lie the basic concepts of aggregate fiscal discipline, budget preparation, budget execution and audits, and accountability, which should be enshrined in laws and regulations.

Overview

Those countries that have made progress towards PFM reforms have, in general, had laws in place since the late 1990s stipulating basic policies on public financial management, with the aim of restoring fiscal health. Such laws go by several names, including "organic budget law," "fiscal responsibility law," "budget system law," and so forth. However, they all establish: (1) the basic principles of budgeting (annual orientation, etc.); (2) the budget preparation process (including the budget planning schedule, etc.); (3) budget execution and audit procedures; and (4) the alignment of authority and responsibility for the budgeting process within parliament and the central government ministries and/or agencies charged with its execution. Some countries have included budget and financial provisions in the constitution.

Again, with regard to the rules to ensure aggregate fiscal discipline, some countries have determined ratios for the budget deficit and outstanding central government public debt as a share of GDP, and have established organizational structures and/or institutional frameworks to oversee compliance.

Depending on the country, the rules on aggregate fiscal discipline may be enshrined in law or subject to approval by the legislature. A famous example is the EU's Maastricht Treaty, which established stringent criteria for Eurozone members, who were required to limit their budget deficit to within 3 percent of GDP and outstanding public debt to within 60 percent of GDP, subject to penalties. Mongolian budget law imposes limits of 3 percent and 40 percent, respectively, on budget deficits and outstanding public debt, while in Indonesia the government is required to keep its budget deficit to within 3 percent and outstanding public debt within 60 percent of GDP.

Reference: Nigeria's Fiscal Responsibility Act of 2007
http://frc-nigeria.org/Fiscal%20Responsibility%20Act.pdf

Checkpoints for assessing progress of PFM reforms

When assessing a country's progress in PFM reforms, the first task is to confirm whether it has established an organic budget law and/or fiscal responsibility law, and, if so, how have provisions been made and what are the provisions for such basic matters as the fiscal year, the budget preparation process and schedule, budget execution, final accounts, reporting, audits, and the roles of the relevant organizations, including parliament. Additionally, where there are rules covering aggregate fiscal discipline, confirm whether these are enshrined in law or subject to approval by the legislature. In such instances, it is important to ascertain whether a system or mechanism has been established to oversee compliance. Note, however, that the existence of laws governing PFM is no guarantee of compliance. Specifically, it should be noted that even for OECD member countries compliance with the long- and medium-term fiscal strategies and public finance rules that new governments are required to introduce in accordance with organic budget law[2] is no easy matter.

The following scale is used to measure progress in PFM reforms.

Level	Contents
Level 4	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established and organizational settings exist**. **Those have become conscious**.
Level 3	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established and organizational settings exist**. **But those have not become conscious**.
Level 2	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established, but organizational settings do not exist**.
Level 1	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are not established**.

Reference: Findings of tendencies from PEFA Indicators.

PEFA has not established a performance budget indicator.

[2] Hideaki Tanaka, *Nihon no Zaisei* (Japanese Public Finance), Chukoshinsho, p. 123.

4-3. Budget Credibility and Execution

Budget credibility is a prerequisite for obtaining precise information on the budget outlook of the recipient country for allocations to a specific sector and/or project. Meanwhile, budget execution is a barometer of the entire government and counterpart organization capabilities in terms of project implementation.

Overview

Budget credibility is a key element of expenditure policy analysis. Generally, budget appropriations (funds for programs, etc., that have been voted on by the legislature) and final accounts are compared on an aggregate basis and against a breakdown of major budget items. Smaller deviations between appropriated and executed budgets are considered to be indicative of greater budget credibility. Data on fluctuations in budget credibility indicators (the percentage and frequency of such deviations) contain a considerable volume of consolidated information regarding, for example: (1) whether the budget preparation is realistic, (2) whether authorization and appropriation have control over their cash flows, and (3) whether expenditures are managed during execution. Where budget credibility indicators are deteriorating, it is essential to investigate the causes.

Implications for the partner country

A lack of budget credibility arises due to the approval of expenditures by the legislature over and above its capacity to pay and the preparation of numerous in-year supplementary budgets. A government may be able to spend over its initially budgeted expenditure insofar as it has the necessary revenue support. However, if this revenue support does not exist, it will be unable to allocate the appropriations to line ministries and implementing agencies as requested. This will necessitate spending cuts across the board and prevent the government from executing public works projects and service delivery as planned (note that similar problems can occur when revenue forecasts are lower than actual spending, though PEFA assessment results suggest that revenue forecasting is reasonably accurate even in low income countries). The expectation of a major change in spending for administrative budget lines against initial allocations also makes it difficult for ministries to draw up budget execution plans. Where budget credibility is not assured, the financial authority is forced to adopt a cautious approach, requiring revenue and/or income support even in respect of budget requests from line ministries and implementing agencies.

Again, the level of arrears provides a clear indication of compliance in budget execution. A high level of arrears can indicate a number of different problems, such as inadequate expenditure commitment controls, inadequate cash rationing, and inadequate budgeting for contracts.[3] Non-compliance in budget execution means that the financial authority will have no choice but to perform some kind of review during the budget preparation process for the coming fiscal year.

Implications for JICA projects

It is important to collect and analyze information on past, present, and future budget allocations to the sector that will receive JICA support in the recipient country, in considering country analysis work, individual project reviews, and the financial sustainability of projects in progress. This is premised on the credibility of the budgets prepared by the recipient government. In order to confirm that the recipient country is capable of covering its portion of the expenses on a JICA project that is to be implemented in that country, you will need to obtain information on the annual budget for the

[3] PEFA Performance Measurement Framework, revised January 2011 (PEFA 2011).

current fiscal year and expenditure forecasts from the government and check that the necessary funds have been included; however, this analysis cannot be undertaken appropriately if there are frequent deviations between the budget at the beginning of the fiscal year and final accounts.

For JICA, compliance in budget execution, both that of the whole government and that of the implementing agency, is critical. Even if project funds are shown in the budget, there is no way of knowing whether the amounts will be disbursed in accordance with the JICA project schedule. It is possible that the entire budget for the year will be executed in the final two months of the fiscal year. Accordingly, due caution needs to be exercised in countries and/or counterpart organizations with high levels of arrears. As stated above, this may be indicative of some degree of non-compliance in budget execution. On a large-scale infrastructure project, for example, this could give rise to budget execution problems even if construction expenditure and post-construction operation and maintenance expenditure have been planned for in accordance with the original plan, resulting in delays in construction work.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing progress in PFM reforms in this area: (1) deviation between aggregate budget expenditure and final accounts; (2) deviation between the budget composition of expenditure and final accounts (i.e., the administrative classifications assigned to Ministry A and Ministry B, etc.); (3) deviation between budget revenue and final accounts; or (4) stock of arrears. Items (1) through (3) will provide an indication of the degree of budget credibility, with (1) and (2) indicating credibility on the expenditure side and (3) indicating credibility on the revenue side. Item (4), meanwhile, is indicative of compliance in budget execution.

As a rule of thumb, PEFA looks at the frequency of deviations in the last three years and assigns scores accordingly. For stock of arrears, which serves as a barometer of compliance in budget execution, PEFA looks at the availability of data on the stock of arrears (as the boundary between a D score and a C score) and at whether such data, if any, is generated through routine procedures or on an ad-hoc basis. It also examines the coverage of the data on stock of arrears in terms of central government ministries, departments, and agencies to establish whether it is complete or partial, with scores assigned accordingly.

The following scale is used to measure progress in PFM reforms. In each case, the calibration is based on the frequency of deviation between budget and final accounts in the last three years.

[Variance in the original budgeted expenditure and final accounts]

Level	Contents
Level 4	**In no more than one out of the last three years** has the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 5%** of budgeted expenditure.
Level 3	**In no more than one out of the last three years** has the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 10%** of budgeted expenditure.
Level 2	**In no more than one of the last three years** has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to **more than 15%** of budgeted expenditure.

Level 1	**In two or all of the last three years** the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 15%** of budgeted expenditure.

Note: Equivalent to PEFA performance indicator PI-1.

[Variance in expenditure composition between the budgeted expenditure and actual expenditure]

★ A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 5% in no more than one of the last three years**.
Level 3	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 10% in no more than one of the last three years**.
Level 2	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 15% in no more than one of the last three years**.
Level 1	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 15% in at least two of the last three years**.

Note: Equivalent to PEFA performance indicator PI-2.

[Variance in aggregate revenue out-turn and original approved budget]

Level	Contents
Level 4	Actual domestic revenue was between 97% and 106% of budgeted domestic revenue **in at least two of the last three years**.
Level 3	Actual domestic revenue was between 94% and 112% of budgeted domestic revenue **in at least two of the last three years**.
Level 2	Actual domestic revenue was between 92% and 116% of budgeted domestic revenue **in at least two of the last three years**.
Level 1	Actual domestic revenue was below 92% or above 116% of budgeted domestic revenue **in two or all of the last three years**.

Note: Equivalent to PEFA performance indicator PI-3.

[Stock of arrears]

★ A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	The stock of arrears is low (i.e., is **below 2%** of total expenditure). **Reliable** and complete data on the stock of arrears is generated through routine procedures at least **at the end of each fiscal year** (and includes an age profile).
Level 3	The stock of arrears constitutes **2-10%** of total expenditure, and there is evidence that **it has been reduced significantly** (i.e., more than 25%) **in the last two years**. Data on the stock of arrears is **generated annually**, but **may not be**

	complete for a few identified expenditure categories or specified budget institutions.
Level 2	The stock of arrears constitutes **2-10%** of total expenditure, and **there is no evidence that it has been reduced significantly in the last two years**. Data on the stock of arrears has been generated by at least one comprehensive **ad hoc exercise** within the last two years.
Level 1	The stock of arrears **exceeds 10%** of total expenditure. **There is no reliable data** on the stock of arrears **from the last two years**.

Note: Equivalent to PEFA performance indicator PI-4.

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trends. (Note: None of these trends is absolute, and these findings should not be taken as categorical.)

- PI-1: No observed difference based on income level.
- PI-2: Evidence of a weak correlation.
- PI-3: No observed difference based on income level; some difference is inevitable.
- PI-4: Evidence of a weak correlation.

4-4. Budget Comprehensiveness

Budget comprehensiveness is essential to the maintenance of aggregate fiscal discipline and the realization of effective and strategic allocation of the meager budgets of recipient countries.

Overview

Where possible, a country's budget should be consolidated into a general account that offers a comprehensive overview of its policies for the fiscal year. This is known as budget comprehensiveness and is one of the basic principles of budgeting. With government activities becoming increasingly wide-ranging and complicated, however, there are some public funds that are managed independently of the general account. Separate accounts may be established for a specific purpose or because there is a need to earmark specific revenue for a specific expenditure item, and these accounts are referred to as extra-budgetary funds (EBFs). EBFs include social security and the funds used for road maintenance (road funds), among others. Japan's Special Accounts are another example of extra-budgetary funds. Other examples are the quasi-fiscal activities of state-run or public financial institutions using internal generated funds.

Implications for the partner country

Where major expenditure items are not included in the general account or the comprehensiveness of information included in budget documentation is not assured, it will have a major impact on the government's ability to maintain aggregate fiscal discipline and achieve strategic allocation of resources. For example, if a country's public finances are strained and it is attempting to maintain and/or strengthen aggregate fiscal discipline, and if a country has a large percentage of extra-budgetary funds that are not included in the general account and not subject to oversight by the legislature, it means that these funds are not covered by the rules on aggregate fiscal discipline. A high level of extra-budgetary expenditure is not desirable from the perspective of strategic allocation of resources either, since there is no guarantee that the necessary funds are being allocated without duplication. The budget may be referred to as comprehensive, but if the actual allocation methods for appropriations and other procedures are not standardized across the board, appropriation allocation cannot be predicted. Where fund use is obscure, it will be obvious that it can lead to the development of corrupt practices. Moreover, if aggregate budget data is unavailable, it will affect the reliability of macro-economic projections. However, where a degree of discipline is assured through cabinet or parliamentary oversight, the existence of extra-budgetary funds and quasi-fiscal activities may be justified.

Implications for JICA projects

For JICA, it is important to ascertain how a recipient government maintains aggregate fiscal discipline over fiscal management. In analyzing the current reality in the recipient country, it is also essential to gain an understanding of the state of public finances and the macro-economy. Even if there are rules on aggregate fiscal discipline, however, if the coverage of these rules is limited to certain budgetary activities or there are extra-budgetary activities that are not covered by such rules, then the ability to maintain aggregate fiscal discipline is put at risk. Again, if there is a lack of comprehensiveness in the budget, it will be impossible to obtain aggregate budget data, have confidence in the country's macro-economic forecasts, or assess the government's ability to finance its debt. These are risk factors for the maintenance of aggregate fiscal discipline and may point to a loss of fiscal stability and sustainability in the future, thereby putting the country's sovereign credit rating at risk. Significant expenditure on extra-budgetary activities may also reduce the budget available for development projects.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in the areas of: (1) for total expenditures, the percentage occupied by extra-budgetary funds and quasi-fiscal activities that are not included in the general account in the annual budget, in-year financial statements, or final statements; and (2) the degree of control over the way in which extra-budgetary funds and quasi-fiscal activities are managed.

- The only way to assess (1) is to look at the percentage of extra-budgetary funds and quasi-fiscal activities included in the annual budget, in-year financial statements, and final statements. PEFA uses a numerical scoring method for its ratings, where the level of unreported extra-budgetary funds is "more than 10% of total expenditure" (D), "5-10% of total expenditure" (C), "1-5% of total expenditure" (B), or is "below 1% of total expenditure" (A).
- To assess (2), it is necessary to look at what discipline is functioning (discipline should be consistent with that applied to general budget operations).[4] Given this, insofar as a reasonable and viable percentage of extra-budgetary funds are subject to discipline that is consistent with that applied to general budget operations, its effective functioning will offer an indication of the government's progress in PFM reforms.

The following scale is used to measure the progress of PFM reforms. A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **is insignificant (below 1% of total expenditure)**. **Rules** to manage extra-budgetary

[4] Shah (2007), *Budgeting and Budgetary Institutions*.

	expenditure (equivalent to the general budget) **are established and cover all of the operation of extra-budgetary funds**.
Level 3	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 1-5% of total expenditure**. **Rules** to manage extra-budgetary expenditure **(equivalent to general budget) are established and cover most of the operation of extra-budgetary funds**.
Level 2	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 5-10% of total expenditure**. **Minimum basic rules** to manage extra-budgetary expenditure (equivalent to general budget) **are established and applied to main extra-budgetary funds**.
Level 1	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 10% or more of total expenditure**. **Rules** to manage extra-budgetary expenditure (equivalent to general budget) **are not established or not widely understood**.

Note: Equivalent to PEFA performance indicator PI-7.

Reference: Findings of tendencies from PEFA Indicators.

The PEFA indicator for this parameter measures the percentage occupied by extra-budgetary funds and quasi-fiscal activities that are not included in the general account in the annual budget, in-year financial statements, or final statements among total expenditures. An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-7: Evidence of a weak correlation.

4-5. Budget Classification

Budget classification provides a standard yardstick against which to compare actual budget performance and the original approved budgets of the recipient government and counterpart organization.

Overview

Government budgets are assigned several classification codes, which are used to present various dimensions or in discussions on allocation, such as an administrative classification (which states a given percentage decrease in the budgets available for specific ministries) and functional classifications (which state a given percentage increase in military spending for the current year, for example).

The agriculture ministry budget for a country, for example, will use the expense code “233418” for the wages and salaries of the ministry’s employees. A careful examination of the items listed in budget documentation will reveal that it includes classifications such as those shown below. Generally speaking, a line-item budget uses economic classification[5] to identify expense items,

[5] Economic classification identifies the type of category of expense, e.g., “payroll” or “travel expenses,” etc. Japan uses the following economic classifications in its budget: “payroll,” “travel expenses,” “housing expenses,” “facility expenses,” “subsidies

where the “supplementary information” category shown under “economic classification” in the table below corresponds to the “project account classification” used in the Japanese national budget.

Figure 10: Budget Classification (1) Administrative Classification and Economic Classification

Administrative Classification	Economic Classification		
Ministry	Main classification	Sub classification	Supplementary information
Agriculture ministry	Expenses	Compensation of employees	Wages and salaries in cash
23 (2 characters)	3 (1 character)	4 (1 character)	18 (2 characters)

In addition, budget and appendix documentation will frequently provide “functional classifications,” which provide information on the government’s policy intentions. Some examples of functional classification are given below.

Figure 11: Budget Classification (2) Functional Classifications

Functional Classifications		
Main function	Function	Secondary function
Economic Affairs	Agriculture Forestry Fishing	Agriculture
04 (2 characters)	3 (1 character)	1 (1 character)

In contrast to administrative and economic classifications, many countries have not introduced functional classifications. In many cases, the United Nations Classification of the Functions of Government (COFOG) has been adopted in the context of assistance to developing countries, and functional classifications are introduced in the IMF’s Government Financial Statistics Manual (GFSM).[6] The COFOG codes for major government expenditures are listed below (10 divisions).

Ten Main Functional Classification Functions (COFOG standards)			
01	General public service	**06**	Housing and community amenities
02	Defense	**07**	Health
03	Public order and safety	**08**	Recreation, culture, and religion
04	Economic affairs	**09**	Education
05	Environmental protection	**10**	Social protection

Standard COFOG codes are not necessarily introduced in assistance to developing countries; instead, the classifications may be adjusted to accommodate the reality in such countries. For reference, the Japanese government uses the following ten functional classifications: “national agencies,” “local

and commissions,” “transfers to other accounts,” and “other expenses.”

6 COFOG codes are also used in the System of National Accounts (SNA).

finance," "national defense," "national land conservation and development," "industrial development," "education and culture," "social security, etc.," "pensions," "bond expenditures," and "contingency reserves" (with "disaster prevention and recovery" included as a sub-category under "contingency reserves").

References:
The IMF GFSM website: http://www.imf.org/external/pubs/ft/gfs/manual/index.htm
Budget classifications: http://www.imf.org/external/pubs/ft/gfs/manual/pdf/app4.pdf
Expenses: http://www.imf.org/external/pubs/ft/gfs/manual/pdf/ch6.pdf
Revenue: http://www.imf.org/external/pubs/ft/gfs/manual/pdf/ch5.pdf

The economic classifications used in GFS are given below (main categories only).

Economic Classifications Used in GFS (Main Classifications)			
01	Compensation of employees	**05**	Subsidies
02	Use of goods and services	**06**	Grants
03	Consumption of fixed capital	**07**	Social benefits
04	Interest	**08**	Other expenses

The ten standard first-level functional classifications used to classify government expenditure (COFOG) are given below.

Classifications Used in COFOG (Main Classifications)			
01	General public service	**06**	Housing and community amenities
02	Defense	**07**	Health
03	Public order and safety	**08**	Recreation, culture, and religion
04	Economic affairs	**09**	Education
05	Environmental protection	**10**	Social protection

These budget classifications provide a framework for fiscal policy decisions and accountability (see below) and contribute to greater efficiency in budget allocation.

- Budget allocations in line with stated policy objectives.
- Compliance with allocation ceilings under the budget appropriation.
- Reviews of policy and performance after budgets are executed.
- Routine payment operations.

Implications for the partner country

Using the various budget classifications to classify budget items reveals the characteristics of a country's budget, and many countries use these administrative and economic classifications. Some countries, however, do not incorporate the functional classifications in a comprehensive manner. As a result, since the functional classifications necessary for policy analysis are not applied across the budget, it cannot be possible to gain any insight into the country's fiscal policy priorities or to analyze government expenditure from budget documentation or the summary table of functional classifications.

Implications for JICA projects

For JICA, it is important to assess the budget allocations and expenditure levels of the recipient government and for the target sector, irrespective of the aid scheme involved. In doing this, for infrastructure projects, it is critical to establish what budgetary provision was made for the operation and maintenance expenses involved in similar projects and how much of this was actually delivered. In such instances, it is important to establish whether standard budget classifications are used across all key documentation: the budget, budget execution, and final accounts. This being the case, it will then be possible to undertake a sequential spend analysis of expenditure data; it also means that the data for making projections is available.

If, however, standard classifications are not used, it will not be possible to analyze expenditure data over time or to conduct a spend analysis. In such instances, the task is to establish the extent to which the various budget classifications (administrative, economic, and functional) are applied in budget formulation and execution. Where, for example, JICA is providing general budget support and the aim is to improve service delivery in the education and/or healthcare sectors, the availability of expenditure data by economic classification will make it possible to estimate how much of the funds provided for general budget support are consumed in payroll expenses and how much is likely to be allocated for project costs. Again, if the government uses functional classifications, spend analysis can be performed for each of the sectors concerned. If, however, neither economic nor functional classifications are used, it is not possible to analyze either the type of expenses or the purpose of expenditures. What this means is that even if JICA is looking to provide assistance for specific projects, it will not be possible to perform the necessary reviews, nor to track how the funds extended are spent.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) what budget classifications are used, and, if classifications are used, whether they are consistent with IMF GFS standards; and (2) if the budget classifications used are consistent with GFS standards, which GFS classifications are applied and to what extent.

The following scale is used to measure the progress of PFM reforms. It determines whether or not GFS standards are applied, and, if so, which of the GFS classifications are used in budget documentation. (Note: the application of administrative classifications is the minimum requirement.) A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	Budget formulation and execution are **based on administrative, economic, and sub-functional classifications**, using GFS/COFOG standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional classification.)
Level 3	Budget formulation and execution are **based on administrative, economic, and functional classification** (**using at least the 10 main COFOG functions**).
Level 2	Budget formulation and execution are **based on administrative and economic classifications** using GFS standards.
Level 1	Budget formulation and execution are based on a different classification (e.g., **not**

GFS-compatible or **with administrative break-down only**).

Note: Equivalent to PEFA performance indicator PI-5.

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-5: Evidence of a weak correlation.

4-6. Budget Preparation and Budget Allocation

The ability of a government to prepare and formulate its annual budget in accordance with the processes and schedule prescribed by laws and regulations by the start of the fiscal year, and to create the conditions necessary for those organizations charged with executing the budget to do so efficiently, serves as a barometer of basic government capabilities.

Overview

All countries, whether advanced or developing, adopt budget preparation methods of some form or another to enable the formulation of budgets that ensure aggregate fiscal discipline and are in line with forward estimates. The budget preparation work is mainly driven by the finance ministry. However, participation in this process by the majority of public entities means that large numbers of people are involved, and all are intent on securing as much of the budget as possible. Therefore, effective mechanisms and methods need to be put into practice to coordinate the various participants and to ensure that the budget can be prepared in accordance with a pre-determined budget calendar.

In order to ensure aggregate fiscal discipline while budget preparation work is in progress, explicit provision must be made for the process and timetable of the annual budget preparation in laws and regulations. The following provides an example of an illustrative timetable for budget preparation.

Figure 12: An Example of an Illustrative Timetable for Budget Preparation

Months to Budget Approval	Process of Budget Preparation
8 months	Preparation of macro-economic framework
7 months	Ceilings by sector prepared by MOF
	Cabinet approves strategy and ceilings
6 months	Budget circular released
5 months	Line ministries submit budget requests
4 months	Budget requests reviewed by MOF/negotiations
2 months	Draft budget reviewed by Council of Ministers and Budget submitted to legislature
0 months	Legislature scrutinizes and approves budget

The finance ministry needs to set clear budget ceilings for all ministries in the early stages of the budget preparation process using a top-down approach. These ceilings are shown to the line ministries in the form of a budget circular (or budget call) and are then officially announced.

The format of the budget also has important implications for the budget preparation process. Generally speaking, the aforementioned ceilings set upper limits on specific economic or functional classifications. Line-item budgets refer to budgets that place particular emphasis on the economic classification of expenses, and such budgets have traditionally been widely used. However, PFM reforms stress the links between budget and fiscal policy; some countries are being encouraged to move from functional classifications (i.e., classifications linked to policy objectives), to program budgeting, which classifies expenditures in terms of the programs to which they are devoted, and ultimately to performance budgeting, in which results indicators are assigned to specific programs.

Implications for the partner country

In practice, in developing countries, there are some cases in which: the budget preparation process is not managed properly in accordance with a fixed timetable; original budget proposals are delivered to the legislature too late to be heard and insufficient time is allocated to the budget hearing process; the annual budget is not passed before the beginning of the fiscal year; and line ministries are unable to ascertain the level of approved expenditures in the annual budget for several months after the start of the fiscal year. Where large-scale public works projects include a bidding process, potential bidders will require several months to prepare their tenders ahead of the bid and then several more months to conclude contracts and so forth, which may mean that the budget for that project is not executed on schedule in that fiscal year. In some developing countries, the annual budget may not be executed until the final two months of the fiscal year, despite the official adherence to annual orientation in the budget process.

Excessive parliamentary involvement in the budget preparation process may result in bloated expenditures, and while it would be ill-advised to make sweeping judgments as to whether this is good or bad, there is a risk that, as seen in the section dealing with budget comprehensiveness, discipline cannot be maintained over extra-budgetary funds and quasi-fiscal activities.

Implications for JICA projects

For JICA, whether the recipient country passes and executes its budget in accordance with a pre-determined statutory process and timetable is an important item of information. From the perspective of aggregate fiscal discipline and strategic allocation of resources, it is also necessary to determine whether the budget preparation process allows for the revision (in the event of problems) of individual budget proposals from line ministries that are submitted to the cabinet and consolidated by the finance ministry before the proposals are presented to the legislature. A country’s ability to pass its budget before the start of the next fiscal year is one of the most basic indicators of PFM system performance. Delays in passing the budget even after the start of the fiscal year may leave line ministries in the dark about the level of approved expenditures for several months, which could lead to delays in the execution of the counterpart’s portion of the funding. Also, in large-scale infrastructure projects being funded by a Japanese ODA loan, the counterpart’s portion of the budget may not be expended in a timely manner. As a result, this could affect the smooth implementation of the project and the sustainability of aid effectiveness and development outcomes.

It is also important to establish whether or not the JICA project cycle (i.e., the Japanese fiscal year) is in sync with the budget year (i.e., from what month to what month) and the budget preparation calendar of the recipient country, and what relationships they have with one another. If there is no synchronization, it will not be possible to secure the necessary funding for the JICA project once the budget preparation process is complete and the budget has been passed, even if a budget request is submitted to the recipient government. Special caution is required if the JICA project becomes off-budget.

Checkpoints for assessing progress of PFM reforms

At the very least, it is essential to establish what provisions have been made for the budget preparation process and timetable in the budget laws of the recipient country. Once that has been established, the following are optional dimensions for assessing the progress of PFM reforms in this area: (1) adherence to a fixed budget timetable; (2) the existence of effective budget ceilings; (3) the timing of budget approval; and (4) the period available for budget review by the legislature.

- In terms of (1), even if the fiscal year, organizational roles, and budget preparation timetable are provided for in the organic budget law, fiscal responsibility law, or their equivalent, this is no guarantee of compliance. It is necessary to establish the existence of a fixed budget preparation timetable (this is usually provided for in the organic budget law) and, given this, whether delays in the fixed timetable are systematic or not.
- For (2), the issue is to establish the timing and accuracy of the ceilings submitted to line ministries by the finance ministry, whether or not there is cabinet involvement in the setting of budget ceilings, and whether the budget requests submitted by line ministries on the basis of these budget ceilings are subject to cabinet review. The reliability of the budget ceilings presented to line ministries by the finance ministry and the scope of budgetary expenditures to which the ceilings apply (in other words, whether they apply to specific functional or administrative classifications) is a measure of the progress of reform. The boundary lines are: whether budget ceilings are actually being set or not; if so, whether the ceilings are set for specific administrative units (e.g., Ministry A, Ministry B) or for specific functions (e.g., agriculture, forestry and fisheries, healthcare, etc.), or are all-inclusive. As for the timing of presenting budget ceilings, the boundary lines are: whether the budget ceilings that have been approved by cabinet are presented to line ministries before the work on budget requests commences; and if not, whether sufficient time is available between the coordination of budget requests from individual line ministries and the submission of the draft budget to the legislature for the addition of cabinet revisions.
- For (3), the issue is to establish whether the budget has been approved before the start of the fiscal year.
- For (4), the issue is to establish the extent to which the legislature’s reviews are conducted in accordance with a pre-determined process and timetable. Each of these represents a key dimension for assessing the progress of PFM reforms in this area.

The following scale is used to measure the progress of PFM reforms. A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

[Existence of and adherence to a fixed budget calendar]

Level	Contents
Level 4	**A clear annual budget calendar exists**, is generally adhered to, and allows MDAs enough time (and **at least six weeks** from receipt of the budget circular) **to meaningfully complete their detailed estimates on time**.
Level 3	**A clear annual budget calendar exists**, **but some delays are often experienced** in its implementation. The calendar allows MDAs reasonable time (**at least four weeks** from receipt of the budget circular) so that **most of them are able to meaningfully complete their detailed estimates on time**.
Level 2	**An annual budget calendar exists, but is rudimentary, and substantive delays may often be experienced** in its implementation, and it allows MDAs **so little time** to complete detailed estimates that **many fail to complete them on a timely basis**.
Level 1	**A budget calendar is not prepared** OR **it is generally not adhered to** OR **the time** it allows for MDAs' budget preparation **is clearly insufficient to make meaningful submissions**.

Note: Equivalent to PEFA performance indicator PI-11 (i)

[Effective budget ceilings]

Level	Contents
Level 4	**A comprehensive and clear budget circular is issued** to MDAs, which reflects ceilings approved by cabinet (or equivalent) prior to the circular's distribution to MDAs.
Level 3	**A comprehensive and clear budget circular is issued** to MDAs, which reflects ceilings approved by cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission.
Level 2	**A budget circular is issued** to MDAs, including ceilings for **individual administrative units or functional areas**. The budget estimates are reviewed and approved by cabinet only after they have been completed in all details by MDAs, thus **seriously constraining cabinet's ability to make adjustments**.
Level 1	**A budget circular is not issued** to MDAs OR the quality of the circular is very poor OR cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus **having no opportunities for adjustment**.

Note: Equivalent to PEFA performance indicator PI-11 (ii)

[Timely budget approval by the legislature]

Level	Contents
Level 4	**The legislature has**, during the last three years, **approved the budget before the start of the fiscal year**.
Level 3	The legislature approves the budget before the start of the fiscal year, but **a delay of up to two months has happened** in one of the last three years.
Level 2	The legislature has, in two of the last three years, approved the budget **within two months of the start of the fiscal year**.
Level 1	The budget has been approved **with more than two months' delay** in two of the last three years.

Note: Equivalent to PEFA performance indicator PI-11 (iii)

[Legislative scrutiny of the annual budget (procedure/timing)]

Level	Contents
Level 4	The legislature's review covers fiscal policies, medium-term fiscal framework, and medium-term priorities **as well as details of expenditure and revenue**. **The legislature's procedures for budget review are firmly established and respected**. The legislature has **at least two months to review the budget proposals**. Clear rules exist for in-year budget amendments by the executive, **set strict limits** on the extent and nature of amendments, and **are consistently respected**.
Level 3	The legislature's review covers fiscal policies and aggregates for the coming year **as well as detailed estimates of expenditure and revenue**. **Simple procedures exist for the legislature's budget review and are respected**. The legislature has **at least one month to review the budget proposals**. Clear rules exist for in-year budget amendments by the executive, and **are usually respected**, but **they allow extensive administrative reallocations**.
Level 2	The legislature's review covers **details of expenditure and revenue**, but only at a stage where detailed proposals have been finalized. Some procedures exist for the legislature's budget review, but **they are not comprehensive and only partially respected**. The legislature has **at least one month to review the budget proposals**. **Clear rules exist, but they may not always be respected** OR **they may allow extensive administrative reallocation as well as expansion of total expenditure**.
Level 1	The legislature's review is non-existent or extremely limited, OR there is no functioning legislature. **Procedures for the legislature's review are non-existent or not respected**. **The time allowed for the legislature's review is clearly insufficient for a meaningful debate** (significantly less than one month). **Rules regarding in-year budget amendments may exist** but are either very rudimentary or unclear, OR **they are usually not respected**.

Note: Equivalent to PEFA performance indicator PI-27

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trends. (Note: None of these trends is absolute, and these findings should not be taken as categorical.)

- PI-11: No observed difference based on income level; some difference is inevitable.
- PI-27: Evidence of a weak correlation.

Furthermore, from the perspective of ensuring the smooth implementation of JICA projects and the sustainability of aid effectiveness and development outcomes, it is also important to confirm that the counterpart organization of the recipient government is preparing its budget requests in accordance with a pre-determined process and timetable. You should also determine whether the counterpart is resigned to the fact that any budget requests it submits will be rejected, since this is an undesirable state of affairs.

4-7. Medium-Term Perspectives in Budgeting

In budget preparation work, it is important to be mindful of maintaining aggregate fiscal discipline over the entire budget. Regarding infrastructure projects involving construction work that spans multiple fiscal years, it is also important to ensure the provision of costs to cover construction (in not only the first year but also subsequent fiscal years) and the funding needed for operation and maintenance once construction is completed.

Overview

Most countries formulate annual-orientation budgets. Although an annual orientation is effective in terms of budgetary control, it can lead to short-term policy making and contribute to difficulties in the economic management of fiscal policy over the longer term. To compensate for these weaknesses, the integration of a medium-term perspective in budgeting has come into focus in recent years, though this has proved to be a difficult experiment for both advanced economies and developing countries alike.

The integration of a medium-term perspective in budget preparation work involves the reconciliation of indicative budgetary ceilings and forward estimates. Here, "indicative budgetary ceilings" refers to the ceilings that have been set for each budget year on the basis of a medium-term fiscal framework based on macro-economic projections including debt estimates. "Forward estimates" refers to estimates in which the medium-term expenditures have been calculated. In reality, the fiscal policy frameworks compiled by government economic agencies on the basis of macro-economic projections tend to be fairly inaccurate, meaning that the multi-year budget ceilings derived from such inaccurate projections are not particularly reliable. Line ministries are subsequently required to generate their forward estimates on the basis of these unreliable budget ceilings, but since the funding needs of individual ministries are simply tallied together, in many cases it would be difficult to refer to this as national fiscal policy.

Moreover, in some cases the methods used by individual ministries to generate their detailed expenditure estimates for new fiscal policies and/or programs have not been standardized. In developing countries, the estimates of revenue and forward expenditure used in the budget preparation work with a medium-term perspective are in general inaccurate, and this has a negative effect on the credibility of the medium-term expenditure frameworks (MTEFs) that consolidate this data. This means that while a great number of countries have introduced the framework, it is proving troublesome to ensure the workability of the MTEF approach to budgeting.

However, if, for example, an infrastructure project involves construction work or an operation and maintenance period spanning multiple fiscal years, the budget process needs to incorporate some form of medium-term perspective in order to ensure that multi-year funding needs are met, even if the introduction and execution of MTEF are problematic. In such instances, it is necessary to ensure that the recurrent budget is consistent with the investment budget. In establishing whether or not a medium-term perspective has been incorporated into the budget, the first task, for the reasons mentioned above, is to assess the indicators that measure the recipient country's macro-economic framework, the scope and frequency of debt sustainability analysis, and the linkages between investment budgets and recurrent budgets, rather than simply looking at whether it has introduced MTEF per se.

Implications for the partner country

The lack of a medium-term perspective in budgeting could cause problems such that the government is left without prospects for the funding needed to cover construction costs in subsequent fiscal years. This is in spite of the fact that infrastructure projects involving construction work or technical assistance projects continue for several fiscal years. It is also necessary to be able to compute the availability of a recurrent budget for operation and maintenance costs. It is difficult to calculate how much money is available for expenditure commitments in the next few years, and how much funding will be made available for new projects if commitment controls for subsequent years are inadequate.

Implications for JICA projects

For multi-year infrastructure projects involving construction work and/or technical assistance projects, the lack of a medium-term perspective in budgeting means that it is not possible to anticipate that the funds to cover the counterpart's portion of expenses will be made available in the case of grant aid, or that the funds to cover the counterpart's portion of construction costs will be made available in the case of loan assistance. The same applies in the case of operation and maintenance costs.

Checkpoints for assessing progress of PFM reforms

The first task is to ascertain what steps the recipient country is taking to incorporate a medium-term perspective into its budgeting process. Whether it has introduced MTEF, has yet to adopt it, or there is some mention of adopting it in the future, it is necessary to understand where in the process of reform it is right now.
Once that has been established, the following dimensions should be assessed to determine the progress of PFM reforms: (1) the framework for making macro-economic forecasts; (2) the scope and frequency of debt sustainability analysis; and (3) the existence of sector strategies with multi-year costing (of recurrent and investment budgets).

The following criteria are used to measure the progress of PFM reforms. They look at whether the country is creating macro-economic forecasts and whether such forecasts are accurate, the scope and frequency of debt sustainability analysis and the type of debt covered, and also the linkages between investment budgets and recurrent budgets.

A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

[Accuracy of macro-economic forecasts]

Level	Contents
Level 4	**Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years** on a rolling annual basis. **Links between multi-year estimates and subsequent setting of annual budget ceilings are clear** and differences explained.
Level 3	**Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years** on a rolling annual basis. **Links between multi-year estimates and subsequent setting of annual budget ceilings are clear** and differences are explained.
Level 2	**Forecasts of fiscal aggregates** (on the basis of the main categories of economic classification) **are prepared for at least two years on a rolling annual basis**.
Level 1	**No forward estimates** of fiscal aggregates are undertaken.

Note: Equivalent to PEFA performance indicator PI-12 (i)

[Scope and frequency of debt sustainability analysis]

Level	Contents
Level 4	DSA for **external and domestic debt** has been **undertaken annually** during the last three years.
Level 3	DSA for **external and domestic debt** has been **undertaken at least once** during the last three years.
Level 2	A DSA **at least for external debt** has been **undertaken once** during last three years.
Level 1	**No DSA** has been undertaken in the last three years.

Note: Equivalent to PEFA performance indicator PI-12 (ii)

[Linkages between investment budgets and recurrent budgets]

Level	Contents
Level 4	**Investments are consistently selected on the basis of relevant sector strategies** and **recurrent cost implications in accordance with sector allocations** and included in forward budget estimates for the sector.
Level 3	**The majority of important investments are selected on the basis of relevant sector strategies** and **recurrent cost implications in accordance with sector allocations** and included in forward budget estimates for the sector.
Level 2	Many investment decisions have **weak links** to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.
Level 1	Budgeting for investment and recurrent expenditure are **separate processes** with no recurrent cost estimates being shared.

Note: Equivalent to PEFA performance indicator PI-12 (iii)

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-12: No observed difference based on income level.

4-8. Performance Evaluation in the Budgeting Process

With many developing countries in the process of introducing program budgets or performance budgets, it is important to know what kind of methods are used in budget preparation in the recipient country, what provision is made for the sectors targeted for JICA assistance, and what impact the operation of a program budget or performance budget will have on allocations to these sectors.

Overview

There are two budgeting formats that enable information on budget performance to be reflected in the budget preparation work: program budgets and performance budgets. From the perspective of sequencing PFM reforms, the first task is to ensure that the country is capable of properly managing a line-item budget before making the transition to a program budget and eventually to a performance budget.

Figure 13: A Comparison of Line-Item, Program and Performance Budget Formats

Feature	Line item	Program	Performance
Content	Expenditures by objects (inputs and resources)	Expenditures for a cluster of activities supporting a common objective	Presentation of a results-based chain to achieve a specific objective
Format	Operating and capital inputs purchased	Expenditures by program	Data on inputs, outputs, effects, and reach for each Objective
Orientation	Input controls	Input controls	A focus on results
Associated management paradigm	Hierarchical controls with little managerial discretion	Hierarchical controls with managerial flexibility over allocation to activities within the program	Managerial flexibility over inputs and program design, but accountability for service delivery and output performance

Source: Adapted from "Table 5.1: Features of Alternative Budget Formats" in Shah (2007) *Budgeting and Budgetary Institutions*.

There are four types of performance budget, which are distinguished on the basis of the extent of feedback on performance each incorporates into the budget preparation dialogue. The ultimate challenge in the budget preparation process is to reflect feedback on performance into adjustments to budget allocations. However, since all government departments are competing for government funds in a bid to expand their own department, robust systems and strong political leadership are essential to ensuring that any adjustments to budget allocations reflect the feedback on actual budget performance. For this reason, many countries struggle to utilize budget allocations for anything other than improving the efficiency of performance evaluations.

Figure 14: Types of Performance Budget

Name	Contents
Performance-reported budgeting (PRB)	Information on performance evaluation is attached as budget supporting documents, but this information is not actually used for budget allocation by the budget authority.
Performance-informed budgeting (PIB)	Information on performance evaluation is attached as budget supporting documents, but this information does not play a main role in budget allocation.
Performance-based budgeting (PBB)	Information on performance evaluation is attached as budget supporting documents and to some extent plays an important role in budget allocation.
Performance-determined budgeting (PDB)	Information on performance evaluation plays a more important role for budget allocation than in PBB.

Implications for the partner country

It is no easy matter to explain the problems created for developing countries by the failure to utilize performance evaluations in budget preparation work. From the perspective of sequencing PFM reforms, there is arguably no need to rush a country that is not succeeding in managing public finance with its current line-item budget system into making the transition to program budgets or performance budgets. In his keynote speech at the Centre for Aid and Public Expenditure (CAPE) Conference 2013 on Budgeting in the Real World, which was hosted by the Overseas Development Institute (ODI) at its offices in London in November 2013, University of Maryland Professor Allen Schick told participants that: "advanced economies experienced no problems when they used line-item budgets. It is only recently that budgeting systems in these countries have evolved to become more program- and/or performance-focused in an attempt to strengthen government accountability for what has been accomplished with public money."[7] On the other hand, there are countries, such as Indonesia, that are just about to introduce performance budgets as a tool to control over-blown budget requests from line ministries and excessive intervention by government ministers (so called pork-barrel politics). In summation, the problem for developing countries that have not introduced a program budget or performance budget could be described as one of motivation or political will for reform.

Implications for JICA projects

As the above indicates, the significance for JICA is not easy to explain either. At the same time, however, it seems sensible to ascertain, as far as possible, what progress is being made on the introduction of a program budget or performance budget system in the recipient country, what efforts the counterpart organization is making to bring its budget presentations in line with this system, and how the budget intended for the JICA project is dealt with in budgetary documentation. It goes without saying that in such instances, the JICA project in question should merit a budget allocation by the recipient government.

[7] The link to Professor Schick's presentation is given for reference: http://www.youtube.com/watch?v=mtXV0E13rfU

Checkpoints for assessing progress of PFM reforms

At the bare minimum, it is important to establish what kind of budget preparation methods the recipient country employs, i.e., whether its budgets are arranged by line item, are linked to specific programs, or are performance-based. If the country is aiming to introduce a program-based or performance-based system, it will be necessary to look at the scenario for the introduction and progress situation in this process. Even if the country targeted for aid has introduced a program budget or performance budget system, it is advisable to determine whether the budget presentations submitted by the counterpart ministry/department to the finance ministry are in line with the requirements for the target sector and/or ministry/department in question, and what provision is made in such presentations for the target sector.

Once this information has been obtained, the following are optional dimensions for assessing the progress of PFM reforms in this area: start by looking at whether the recipient country has built a system that facilitates effective performance evaluations that has a performance budget in view (in other words, whether it has introduced a workable results chain and/or key performance indicators); and, assuming this to be the case, examine how the results obtained from the performance evaluations are coordinated and utilized. In this instance, it is important to establish the budget categories to which performance budget methods are being applied. It is also important to establish whether the prevailing culture in the recipient country (i.e., in parliament, civil society, and the media) favors the introduction of performance evaluation, and whether internal and external audits are capable of addressing results-based accountability.

The following criteria are used to measure the progress of PFM reforms. The assessment is made on the basis of the existence of performance evaluation mechanisms as a prerequisite for the introduction of performance budgets, whether the relevant results chains and/or KPIs are workable, and whether performance evaluation outcomes are duly reflected in decisions on budget allocations. (Note that the degree of correlation between performance evaluation results and budget allocations will vary depending on the performance budget category that the recipient country intends to introduce and how far along it is in the process of introduction.)

Level	Contents
Level 4	**There is a performance evaluation system for performance budgets**. Based on performance information, **performance evaluation is conducted** by all the ministries and agencies. **The results are reported to the public**. **The results are used** depending on the type of performance budget. **Internal audits and external audits consider the results**.
Level 3	**There is a performance evaluation system for performance budgets**. Based on performance information, **performance evaluation is conducted** by major ministries and agencies. The results are reported to the public. **The results are used** depending on the type of performance budget.
Level 2	**There is a performance evaluation system for performance budgets**. Based on performance information, **performance evaluation is conducted** by major ministries and agencies. **The results are reported but not used** as intended.
Level 1	**There is not an effective performance evaluation system** intended for performance budgets. Based on performance information, performance evaluation is conducted by all ministries and agencies (e.g., a result-chain system and effective indicators are not introduced).

For reference, for both program budgets and performance budgets, the incorporation of a results-based framework into national development plans and/or sector development strategies alongside the introduction and effective application of budget classifications are essential prerequisites to the utilization of performance evaluation outcomes in the budget preparation work.

Reference: Findings of tendencies from PEFA Indicators.

PEFA has not established an indicator for performance budgets. For reference, according to Performance and Programme-Based Budgeting in Africa: A Status Report, which was published by the Collaborative Africa Budget Reform Initiative (CABRI) in 2012, of the 46 countries in Sub-Saharan Africa that have adopted or attempted to introduce either a program budget or a performance budget, only two have succeeded: South Africa and Mauritius.

The CABRI website:

http://www.cabri-sbo.org/images/documents/PPBB/cabri%20status%20report_english.pdf

Note that two important points require due caution from the perspective of sequencing PFM reforms: (1) whether the recipient government has reached a level at which it is capable of appropriately managing a line-item budget to some extent, since this is a necessary prerequisite for the introduction of a performance budget; and (2) whether the devolution necessary for an effective performance budget has been conducted from the finance ministry to line ministries, and whether this devolution has been accompanied by managerial reform within the line ministries. However, these factors will be influenced by the context in which the recipient country is seeking to introduce a performance budget, and by the type of performance budget it aims to introduce, and due care should be taken to avoid making sweeping generalizations.

Reference: Criteria for assessing the effective functioning of line-item budgets

- There is express provision made for the budget preparation process and timetable in laws and regulations, and this is generally adhered to.
- Credible budget ceilings are presented by the finance ministry to line ministries at the appropriate time.
- Sufficient time is available for the cabinet to make revisions before the government budget draft is submitted to the legislature. Sufficient time is available for the legislature to review the government budget draft submitted by the cabinet. The mechanisms designed to keep bloated budget proposals in check are functioning effectively to some extent.
- Supplemental budgets and other in-year adjustments to budget allocations are infrequent, and the budget is reasonably credible.
- The same budget classifications are used in the processes from budget preparation and execution and to final accounts.

4-9. Cash Management and Planning, and Disbursement

Effective execution of the budgets allocated to JICA projects by the recipient government in accordance with original agreements is an important prerequisite for the provision of aid.

Overview

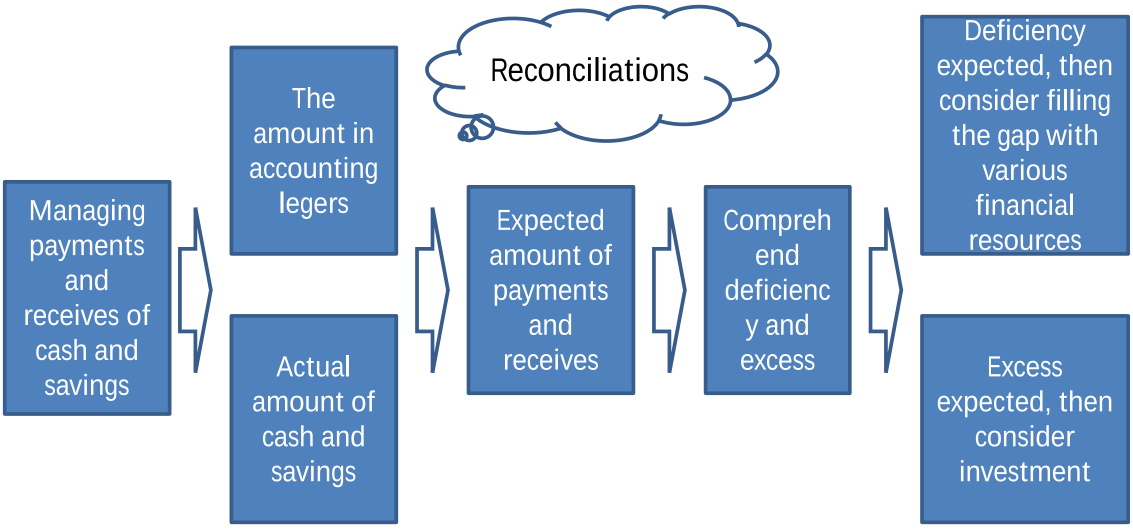
In deliberating the issue of PFM for a specific country, the treasury function (treasury management), which includes cash management and various other activities, is of critical importance to operational efficiency.

Insofar as the treasury is functioning properly, firstly, correspondence between the balance of cash and deposits as booked and the balance of government bank accounts will provide a proper indicator of current treasury funds. Secondly, there will be proper forecasting of future cash flows, clarification on cash surpluses and/or shortfalls, financial planning of cash flows, and measures in place to deal with any shortfalls or surpluses (operational procedures for budgetary surpluses, procurement methods to deal with revenue shortfalls, and strategy and policy on debt management to ensure discipline).

This means that, insofar as the allocation of appropriations process is functioning effectively, individual line ministries are able to submit requests for treasury funds to the finance ministry every quarter or in accordance with the fixed budget calendar for the year, and the finance ministry will disburse funds accordingly, thus enabling the line ministries to execute their budgets in a coordinated and timely manner.

However, since the term “treasury” is not one that is generally encountered in everyday life, it may prove difficult to develop a sense of affinity with this function. In the simplest of terms, it involves: (1) recording cash and deposit balances in the government’s books; (2) reconciling this data on treasury funds with the balances held in government bank accounts; (3) generating a bank reconciliation statement to address any discrepancies created by the timing of check clearance; (4) generating estimates of revenue and expenditure and checking whether there will be any surpluses or shortfalls; and (5) then devising financing and/or procurement methods to deal with projected shortfalls (e.g., expenditure cuts or a loan from a domestic/foreign bank) or operational procedures to deal with budgetary surpluses.

Figure 15: An Image of the Treasury Function



Implications for the partner country

If the treasury is not functioning effectively (i.e., it is not possible to get information on current cash balances or forecasts), there is a risk that the fiscal authorities will not authorize budgetary requests from line ministries because they are unable to obtain proof of the availability of treasury resources. There may also be cases in which there is firm political will to maintain aggregate fiscal discipline as a means of preventing the accumulation of national debt, or in which a government is intent on securing funds as a contingency against future risk.

This can lead to procedural problems with the allocation of authorized budget items to line ministries, which, in combination with other fiscal risk factors, can make the finance ministry cautious in respect of the amounts it allocates to sector ministries or that prompts it to make cuts to its original allocations. Since allocations are disbursed on the basis of actual revenue growth, particularly in the first and second quarters, budgetary allocations will frequently be substantially lower than the planned amounts.

Implications for JICA projects

In infrastructure projects, for example, there are cases in which advances are made to contractors while construction work is in progress or payments are made on the basis of work progress. In such instances, ineffective cash management will make it impossible to check up on the availability of treasury funds, with the result that the counterpart organization will be unable to deliver its portion of the funds in a systematic and timely fashion. Similar problems can also arise in technical assistance projects. What this means is that project activities cannot proceed in accordance with the plan of operation, which is likely to have a negative impact on the realization of project objectives.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: cash management, cash planning, and the allocation of the authorized budget.

- In terms of cash management and planning, the first task is to establish the frequency with which government cash balances are calculated. Does the calculation occur irregularly, or on a monthly basis, a weekly basis, or a daily basis? The next task is to establish the frequency and scope of bank reconciliation. Does it take place less frequently than quarterly, within two months of the end of each quarter, or within one month of the end of each quarter? Does the reconciliation cover only treasury-managed bank accounts or all central government bank accounts? In terms of cash management, are cash flow forecasts prepared and monitored (i.e., data is kept on actual cash inflows and outflows)? If so, are these cash flow forecasts updated even after implementation at the beginning of the year, and, if so, are they updated regularly or irregularly, and at what intervals?

l In terms of the allocation of the authorized budget, (1) how accurate are the ceilings for expenditure commitments and what rules govern such commitments, and (2) how frequently are in-year adjustments made to budget allocations? With (1), it is important to establish whether the treasury (finance ministry) sets commitment ceilings for line ministries. If so, is the information on the ceilings accurate and is it released to line ministries at pre-determined intervals throughout the fiscal year? If line ministries are given no indication of in-year ceilings on expenditure commitments, it will lead to uncertainty over the amount of the allocation of appropriations for that year. Again, frequent in-year adjustments to budget allocations will mean that line ministries have no indication of actual resource availability for commitments during the year.

The following criteria are used to measure the progress of PFM reforms in this area. They assess the frequency of government cash balance calculations and bank reconciliations, whether the reconciliations cover all or only some of the government's accounts, the timing of the presentation of commitment ceilings to line ministries by the finance ministry, and the frequency of in-year adjustments to budget allocations.

[Frequency of government cash balance calculations]
★ A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	**All cash balances are calculated daily** and consolidated.
Level 3	**Most cash balances are calculated** and consolidated **at least weekly**, but **some extra-budgetary funds remain outside** the arrangement.
Level 2	**Calculation** and consolidation **of most government cash balances** take place **at least monthly**.
Level 1	**Calculation of balances** takes place **irregularly**.

Note: Equivalent to PEFA performance indicator PI-17 (ii).

[Frequency of bank reconciliations]
★ A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	Reconciliation and clearance of **suspense accounts** and advances take place at least quarterly, **within a month from end of period**.
Level 3	Reconciliation and clearance of **suspense accounts** and advances take place at least annually **within two months of end of period**.
Level 2	Reconciliation and clearance of **suspense accounts** and advances take place

	annually in general, **within two months of end of year**.
Level 1	**Reconciliation and clearance of suspense accounts and advances take place** either annually **with more than two months' delay**, OR less frequently.

Note: Equivalent to PEFA performance indicator PI-22 (ii).

[Cash management]

★ A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	**A cash flow forecast is prepared for the fiscal year, and updated monthly on the basis of actual cash inflows and outflows**.
Level 3	**A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows**.
Level 2	**A cash flow forecast is prepared for the fiscal year**, but **is not** (or only partially and infrequently) **updated**.
Level 1	**Cash flow planning and monitoring are not undertaken** or are **of very poor quality**.

Note: Equivalent to PEFA performance indicator PI-16 (i).

[Accuracy of information on commitment ceilings and commitment rules]

★ A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	MDAs are able to plan and commit expenditure for **at least six months in advance** in accordance with the budgeted appropriations.
Level 3	MDAs are provided reliable information on commitment ceilings **at least quarterly in advance**.
Level 2	MDAs are provided reliable information **for one or two months in advance**.
Level 1	MDAs are provided commitment ceilings **for less than a month** OR **no reliable indication** at all of actual resource availability for commitment.

Note: Equivalent to PEFA performance indicator PI-16 (ii).

[Frequency and transparency of in-year adjustments to budget allocations]

★ A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	Significant in-year adjustments to budget allocations take place **only once or twice in a year** and are done **in a transparent and predictable way**.
Level 3	Significant in-year adjustments to budget allocations take place **only once or twice in a year** and are done **in a fairly transparent way**.
Level 2	Significant in-year budget adjustments are **frequent**, but undertaken **with some transparency**.

Level 1	Significant in-year budget adjustments are **frequent** and not done **in a transparent manner**.

Note: Equivalent to PEFA performance indicator PI-16 (iii).

Source: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trends. (Note: None of these trends is absolute, and these findings should not be taken as categorical.)

- PI-17: No observed difference based on income level.
- PI-22: Evidence of a weak correlation.
- PI-16: As above.

4-10. Debt Management

For the recipient country, effective debt management is critical from the viewpoint of the sustainability of its government debt.

Overview

In examining the PFM of a specific country, effective debt management strategies and practices are crucial to the maintenance of aggregate fiscal discipline. It is also important to have an awareness of government guarantees and contingent liabilities and to manage the risks associated with them. In principle, debt management involves managing public debt as a portfolio on the basis of a sustainable debt management policy that takes into account the amounts and due dates of individual repayments, interest rates, and the currencies of foreign loans, among other things. However, since there is a lag between the contracting of a loan and the servicing of that debt, irrespective of whether it is short-term or medium- to long-term debt, and because events that affect the repayment terms may occur during the term of the loan, due consideration of these risks is an essential element of sustainable debt management. Again, data needs to be kept on government guarantees and other contingent liabilities that may not require servicing, in addition to the explicit debt described above, as part of the debt management process.

Implications for the partner country

There are cases in which the recipient country has not established basic policy on debt management and has failed to identify the prospects for servicing public debts at the lowest cost to the government from the structure of the debt portfolio. There are also cases in which the government has failed to establish an institutional framework for debt management that includes, for example, strategies for dealing with exchange rate risk and the risks associated with slumps in tax revenue or the domestic refinancing market.

Implications for JICA projects

Ineffectual debt management strategies and practices mean that the government is unable to maintain aggregate fiscal discipline over its domestic and foreign debt, which can create significant risks for macro-economic stability. It may also mean that the country fails to service its Japanese ODA loan on schedule or that there are interruptions in the provision of government guarantees against such a Japanese ODA loan. Alternatively, the country may be borrowing from numerous sources, including Japan, which increases the burden of domestic and foreign debt and reduces debt sustainability, making it more difficult for Japan to extend ODA loans. To be able to identify this state of affairs, it is necessary to assess the country's debt management system and the current status of public debt armed with a basic knowledge of debt management strategies and systems.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) the accuracy of debt data recording and the frequency with which such data is updated; (2) the frequency and quality of central government monitoring of sub-national levels of government, autonomous government agencies, and public enterprises; and (3) the maintenance of discipline over the contracting of loans and the issuance of guarantees.

The following criteria are used to measure the progress of PFM reforms in this area. The indicators measure the frequency with which debt data is recorded, the accuracy of the data, how often the central government monitors the debt levels of sub-national levels of government, autonomous government agencies and public enterprises, what measures are taken to maintain discipline over the contracting of loans and the issuance of guarantees by the government, and whether these are respectively functioning effectively.

A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

[Accuracy of debt data recording]

Level	Contents
Level 4	**Domestic and foreign debt records are complete, updated,** and **reconciled on a monthly basis** with data considered to be **of high integrity**. **Comprehensive management and statistical reports** (covering debt service, stock, and operations) **are produced at least quarterly**.
Level 3	**Domestic and foreign debt records are complete, updated,** and reconciled quarterly. Data are considered to be **of a fairly high standard**, but **minor reconciliation problems occur**. **Comprehensive management and statistical reports** (covering debt service, stock, and operations) **are produced at least annually**.
Level 2	**Domestic and foreign debt records are complete, updated,** and reconciled **at least annually**. Data quality is considered to be **fair**, but **some gaps and reconciliation problems are recognized**. **Reports on debt stocks and service are produced only occasionally** or with limited content.
Level 1	Debt data records are **incomplete** and **inaccurate to a significant degree**.

Note: Equivalent to PEFA performance indicator PI-17 (i).

[Frequency and quality of monitoring of sub-national levels of government, autonomous government agencies, and public enterprises]

Level	Contents
Level 4	All major autonomous government agencies (AGAs) and public enterprises (PEs) **submit fiscal reports** to central government **at least six-monthly**, as well as annual audited accounts, and central government consolidates **fiscal risk issues into a report at least annually**. **The net fiscal position is monitored at least**

	annually for all levels of sub-national (SN) government, and central government consolidates **overall fiscal risk into annual (or more frequent) reports**.
Level 3	All major AGAs/PEs **submit fiscal reports** including audited accounts to central government **at least annually**, and central government consolidates overall fiscal risk issues into a report. **The net fiscal position is monitored at least annually** for the most important level of SN government, and central government consolidates **overall fiscal risk into a report**.
Level 2	Most major AGAs/PEs **submit fiscal reports** to central government **at least annually**, but a consolidated overview is missing or **significantly incomplete**. **The net fiscal position is monitored at least annually** for the most important level of SN government, but a consolidated overview is missing or **significantly incomplete**.
Level 1	**No annual monitoring of AGAs and PEs takes place**, or it is **significantly incomplete**. **No annual monitoring of SN governments' fiscal position takes place** or it is **significantly incomplete**.

Note: Equivalent to PEFA performance indicator PI-9.

[Maintenance of discipline over the contracting of loans and the issuance of guarantees]

Level	Contents
Level 4	Central government's contracting of loans and issuance of guarantees are made **against transparent criteria and fiscal targets**, and always approved by a single responsible government entity.
Level 3	Central government's contracting of loans and issuance of guarantees are made **within limits for total debt and total guarantees**, and always approved **by a single responsible government entity**.
Level 2	Central government's contracting of loans and issuance of guarantees are always approved **by a single responsible government entity**, but are **not decided on the basis of clear guidelines, criteria, or overall ceilings**.
Level 1	Central government's contracting of loans and issuance of guarantees are approved by different government entities, **without a unified overview mechanism**.

Note: Equivalent to PEFA performance indicator PI-17 (iii).

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trends. (Note: None of these trends is absolute, and these findings should not be taken as categorical.)

- PI-17: No observed difference based on income level.
- PI-9: Evidence of a weak correlation.

4-11. Asset Management

Effective asset management by the recipient government (e.g., recording of asset data in an asset ledger and ledger management) is an essential prerequisite for ascertaining the status of equipment and facilities provided and/or upgraded through a JICA project.

Overview

In examining the PFM of a specific country, effective management of state-owned and public assets and the prevention of the loss and/or leakage of such assets are crucial to the maintenance of aggregate fiscal discipline. There are two dimensions to asset management. The first involves the maintenance of an asset management ledger and the collection and recording of asset data; the second involves ensuring that land, buildings, and other state-owned assets are utilized effectively for their designated administrative purposes through the coordination of their usage with the relevant ministries and agencies, and by promoting the transfer and/or disposal of public assets that are not being effectively utilized; the third involves making fair value assessments of state-owned assets and the consolidation of such data for accounting reports.

Implications for the partner country

In practice, many developing countries have not established the structures needed to systematically record data on state-owned and public assets, and there is a lack of clarity on the identity of the organizations, etc., to which such assets revert. Moreover, when public entities are privatized, the relevant asset valuations tend to be extremely time-consuming and expensive. Ineffectual asset management can also lead to the development of corrupt practices.

Implications for JICA projects

Poor asset management may mean that the location of equipment that is supposed to be owned by the developing country in question is unknown, which could lead in turn to inefficient operations from the outset of a project if the use of such assets is a prerequisite. Alternatively, fixtures, vehicles, equipment, and other assets purchased through a JICA project may be lost, but if the data on such assets has not been recorded, there will be no way of confirming such losses. To be able to identify this state of affairs, it is necessary to assess the country’s asset management system and the current status of public assets, armed with a certain degree of basic knowledge of asset management systems.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: the accuracy of asset data recording, and the frequency with which such data is updated.

The following criteria are used to measure the progress of PFM reforms. The indicator measures how often asset data is recorded and the quality of this data.

Level	Contents
Level 4	Recording of asset data is **complete and updated**. Records of asset data in an asset ledger and the actual amounts are **reconciled quarterly**. **There are no material concerns regarding data accuracy and its reconciliation**. The **record of asset data is published at least once a year**.

Level 3	Recording of asset data is **complete and updated**. Records of asset data in an asset ledger and the actual amounts are **reconciled quarterly**, but **a gap exists**. There are no material concerns regarding data accuracy. The **record of asset data is published at least once a year**.
Level 2	Recording of asset data is **complete and updated**. Records of asset data in an asset ledger and the actual amounts are **reconciled at least once a year**, but **a gap exists**. There are no material concerns regarding data accuracy. The **record of asset data is published on an ad-hoc basis**.
Level 1	Recording of asset data is **not complete and considerably inaccurate**.

Reference: Findings of tendencies from PEFA Indicators.

PEFA has not established an indicator for asset management.

4-12. Revenue Management

Effectiveness in the collection of revenues is a cornerstone of fiscal management and PFM. Without it, there can be no discussion of maintaining aggregate fiscal discipline or strategic allocation of resources.

Overview

Revenue management involves establishing general procedures for tax payment, ensuring fairness, and pursuing procedural effectiveness. General tax payment procedures should provide clarity on the tax liabilities of taxpayers, and taxpayers must be convinced of the fairness of the tax assessment system. Governments also need to ensure that the procedures for tax payment are clear and easy to understand. The transparency of the tax inquiries conducted to determine tax liability must also be assured.

In order to ensure clarity and fairness in taxation, taxpayers need easy access to information on their tax liabilities. There also needs to be a functioning tax appeals mechanism that will dispel any concerns taxpayers may have about biased decisions and cultivate a sense of fairness and security. Appropriate penalties also need to be installed to ensure against tax avoidance.

Measures also need to be taken to promote fairness in taxation and the streamlining of payment and collection procedures, which can be facilitated by the introduction of a taxpayer registration system.

Implications for the partner country

Where there are other problems with the tax system, including the failure to establish the concept of tax neutrality, there may also be various problems relating to tax administration, such as: ineffectual taxpayer registration, tax inquiries, tax collection procedures, and the delivery of services to taxpayers; poorly managed tax documentation; no IT-driven streamlining of procedures; a poorly functioning appeals mechanism; and (from the taxpayer's perspective) no clear legal grounds for taxation or clarity with regard to the various tax procedures.

Implications for JICA projects

Ineffectual revenue administration could mean that even if macro-economic forecasts anticipate a certain level of economic growth going forward, there will be budgetary shortfalls unless revenues can be increased commensurately. In consequence, there is a risk that appropriations for a JICA project that have been approved may not be disbursed due to shortfalls in the budget.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) the existence of tax administration systems; (2) the existence of taxpayer services to facilitate compliance with declaration and payment obligations; and (3) effectiveness in tax inquiries and collection procedures.

The criteria for measuring the progress of PFM reforms in this area are presented in the Matrix for Measuring Progress on PFM Reforms (see Appendix 1).

Reference: Findings of tendencies from PEFA Indicators.

Since the aforementioned matrix is not wholly consistent with the relevant PEFA performance indicators, it is not possible to make a straightforward comparison of the respective parameters; for reference, the applicable PEFA performance indicators point to the following correlations (in terms of income levels).

- PI-13: Evidence of a degree of correlation.
- PI-14: Evidence of a degree of correlation.
- PI-15: Evidence of a weak correlation.

4-13. Accounting System and Procedures

Budget execution undertaken in conformity with accounting procedures that are prescribed by laws and regulations is essential to the proper, accurate, and timely disbursement by the counterpart organization of its portion of the funding for a JICA project. Moreover, the formulation and practice of accounting procedures is a necessary condition to obtaining timely and accurate fiscal data from the recipient country.

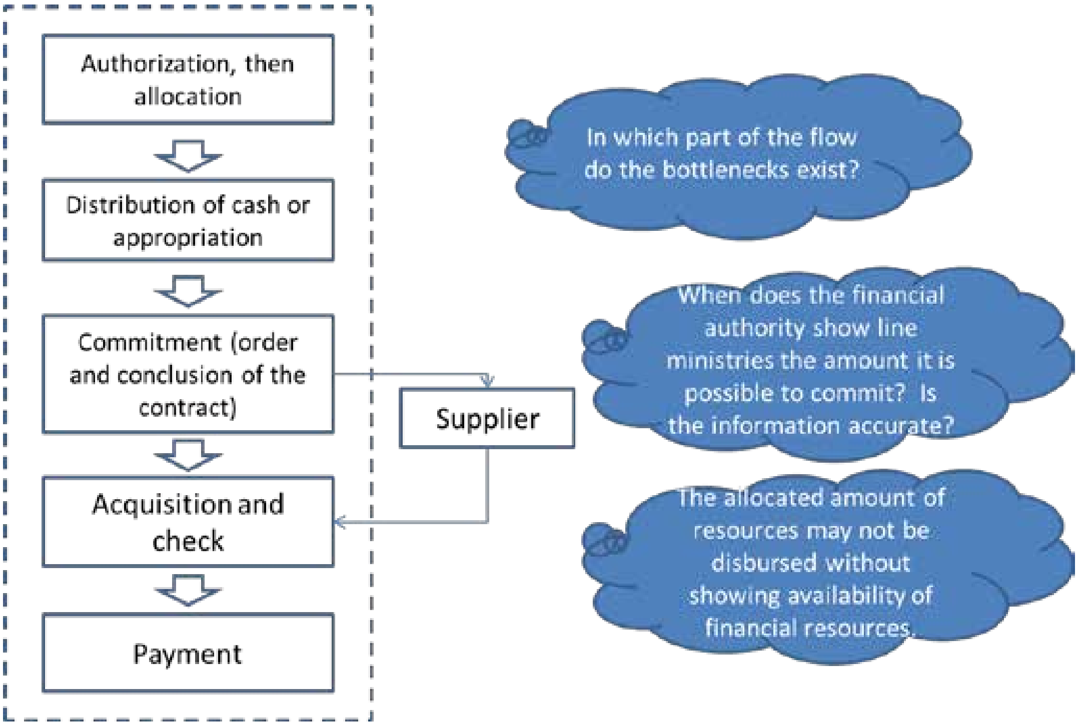
Overview

Accounting procedures cover: (1) approvals by the appropriation of spending ministry and agency budgets and the allocation of budgeted expenditures, (2) expenditure commitments, (3) acquisitions and inspections, (4) the issuing of payment orders, and (5) payments. Note that authorization is generally granted on the basis of budget appropriations that have been approved by the legislature, though there are cases in which the scope of appropriation over actual expenditure is limited to specific quarterly periods or months, and the authorization and appropriation may not be carried out by the same entity.[8]

These procedures are underpinned by accounting rules. Cash basis accounting is generally used in the public sector, whereas modified cash basis accounting is the most widely adopted system, since it takes into account the transfer consolidation period.

[8] Authorization determines policy implementation authority and budgetary ceilings, and is generally granted on the basis of budget appropriations. By contrast, appropriation confers the authority to make actual disbursements. Generally speaking, the finance ministry, for example, will allocate appropriations to spending ministries and agencies on a quarterly or monthly basis in accordance with fiscal policy, with appropriation limited to the scope of this fiscal policy.

Figure 16: A Flow Chart of the Allocation of Budget and Accounting Procedures



Implications for the partner country

In examining the PFM of a specific country, a quick execution procedure is critical from the perspective of operational efficiency. However, where the chart of accounts is unclear and there is a lack of clarity in accounting procedure arrangements and decision-making standards, the adequacy of accounting procedures may not be assured, leading to interruptions in the procedures. In some countries, the national directorate of accounting (finance ministry) will formulate accounting regulations at the national level, while individual ministries and agencies are responsible for developing their own detailed accounting rules. In such instances, accounting procedures cannot be carried out properly on the basis of the national accounting regulations devised by the national directorate of accounting alone, with the result that the procedures adopted by spending ministries and agencies and their local offices are unsystematic and non-standardized. This state of affairs can contribute to the problems described above.

The establishment and introduction of a chart of accounts may seem like a simple matter, but if it has not taken hold, then the officers and departments of spending ministries and agencies may be using different methods to process what in practical terms amount to the same items of expenditure.

In addition, compliance with accounting procedures is absolutely essential to ensuring the accuracy of fiscal reports and final statements, and if this compliance is not assured, it not only throws the credibility of these reports into question, but also affects budget credibility, since it means that macro-economic forecasts, fiscal policy and budget preparation work are being undertaken on the basis of erroneous data.

Implications for JICA projects

Where, for example, accounting procedures have not been standardized, budget execution procedures will take time to complete, which could generate problems by making it impossible to procure goods at the most appropriate time or by preventing the counterpart organization from providing its portion of the funds required for project activities. Again, appropriations allocated to cover the counterpart's portion of expenses on a JICA project may be diverted to other uses resulting in a shortfall in funding for the project in question. In short, adequate accounting procedures are critical to the smooth implementation of JICA projects.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) the development and practice of accounting procedures; and (2) the scope and effectiveness of expenditure commitment rules.

The following criteria are used to measure the progress of PFM reforms in this area. The indicators look at whether a country has developed and maintained methodical accounting procedures, whether it has effective internal controls, whether such controls are routinely violated, and whether the rules and procedures are appropriate without being excessive.

A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

[Development and practice of accounting procedures]

Level	Contents
Level 4	Internal control rules and procedures are relevant, and incorporate a **comprehensive and generally cost effective** set of controls, which are **widely understood**.
Level 3	Internal control rules and procedures incorporate a comprehensive set of controls, which are **widely understood**, but **may in some areas be excessive** (e.g., through duplication in approvals) and **lead to inefficiency in staff use and unnecessary delays**.
Level 2	Internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are **understood** by those directly involved in their application. **Some rules and procedures may be excessive**, while **controls may be deficient in areas of minor importance**.
Level 1	Internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are **not controlled**.

Note: Equivalent to PEFA performance indicator PI-20 (ii) and (iii).

[Scope and effectiveness of expenditure commitment rules]

Level	Contents
Level 4	Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations.
Level 3	Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception.
Level 2	Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated.

Level 1	Commitment control systems are generally lacking OR they are routinely violated.

Note: Equivalent to PEFA performance indicator PI-20 (i).

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-20: Evidence of a weak correlation.

4-14. Public Procurement

The development and appropriate operation of public procurement organizations and systems is, for example, a prerequisite for the selection of equipment and facilities as well as construction contractors for JICA projects by the counterpart organization in a recipient country.

Overview

Public procurement can be centralized or decentralized. In the first instance, the government will establish a central public procurement agency, such as a public procurement management agency. In the second instance, public procurement procedures and authority are transferred to individual ministries and public entities (i.e., decentralized), with their supervision charged to a public procurement oversight organization. In order to ensure the transparency of the procurement process, many procurement systems guarantee the principle of openness and public access to information in respect of contracts above a certain value.

The procurement procedure includes: (1) the establishment of explicit procurement procedures that lay stress on ensuring the transparency of the procurement process; (2) promoting the establishment of the relevant institutional mechanisms, such as the creation of a public procurement management agency; and (3) effective operation of these institutional mechanisms (including the provision of training for both public and private-sector stakeholders). Generally speaking, the legal and regulatory framework for public procurement is enshrined in public procurement legislation.

Implications for the partner country

The development and appropriate operation of a public procurement system is of critical importance to PFM. However, in some countries, the transparency and fairness of the public procurement process is put at risk by the absence of a well-defined legal and regulatory framework for public procurement, or by the absence of well-defined implementing rules (though the basic law is in place), or by ineffectual monitoring of progress in procurement procedures, or by the lack of public access to procurement information (public announcements and their outcomes), or by the absence of an effective appeals system. In consequence, the absence of centralized supervision of public procurement and the fact that public entities take charge of their own procurement transactions may mean that the country has not introduced a competitive bidding system and that there is no administrative body to correct any procedural problems that might arise.

In addition to the foregoing, sub-national levels of government may not have the capacity to adhere to the designated procurement procedure. By contrast, where a public entity has been set up to handle all public procurement (e.g., a public procurement management agency), although individual employees may have the necessary qualifications and experience, the number of personnel may simply be insufficient to the task at hand. Moreover, where procurement procedures are not simple and clearly defined and internal and external audit functions are ineffectual (see below), it inevitably becomes a breeding ground for corruption.

Implications for JICA projects

Where, for example, the recipient country does not have a well-functioning public procurement system complete with detailed implementing rules, the procurement procedures associated with a project that is receiving JICA assistance may not proceed smoothly, which could impact on project progress, and it is also possible that there is a lack of transparency and/or fairness in the procurement process.

Checkpoints for assessing progress of PFM reforms

As optional dimensions for assessing the progress of PFM reforms in this area, the PEFA PFM Performance Measurement Framework provides the following six requirements for assessing the legal and regulatory framework for procurement:

- It should be organized hierarchically and precedence is clearly established;
- It should be freely and easily accessible to the public through appropriate means;
- It should apply to all procurement undertaken using government funds;
- It should make open competitive procurement the default method of procurement and define clearly the situations in which other methods can be used and how this is to be justified;
- It should provide for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints; and
- It should provide for an independent administrative procurement review process for handling procurement complaints by participants prior to signing a contract.

The following criteria are used to measure the progress of PFM reforms. A score of Level 3 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	The legal framework meets all six of the following listed requirements: (1) the organizational hierarchy and procedures of public procurement are clear; (2) access to procurement information by the public is secured; (3) public procurement rules are applied to all government entities; (4) competitive public procurement is the first principle and exceptional ways with reasons are the second principle; (5) all of the required items of procurement information (government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints) are provided for the public; and (6) an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature is secured.
Level 3	The legal framework meets four or five of the above six listed requirements.
Level 2	The legal framework meets two or three of the above six listed requirements.
Level 1	The legal framework meets one or none of the above six listed requirements.

Note: Equivalent to PEFA performance indicator PI-19 (i).

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-19: No evidence of a difference based on income levels.

4-15. Internal Controls and Internal Audits

Internal controls and audits are essential to ensuring that the recipient government and counterpart organization execute their budgets in compliance with the relevant laws and regulations.

Overview

Basic internal audit functions can be broadly divided into two types, as follows: (1) compliance audits, which assess adherence to the laws on appropriations of public funds and other applicable laws and regulations; and (2) financial audits, which look for consistency between government expenditure reports (accounts) and government finances. In recent years, some countries have introduced audits with a more inclusive function that audit the social and economic outcomes and performance of government programs and services (so-called value-for-money audits and performance audits). Note that due caution is needed since there are respectively different internal audit systems in English-speaking, French-speaking, and Spanish-speaking countries.

Implications for the partner country

There are cases where: (1) actual practices cannot be conducted in accordance with standard procedures for internal audits; (2) the reporting lines extending from subordinate agencies to the spending ministries are unclear; (3) audit reports submitted to ministry-level audit committees are not properly discussed; and (4) audit findings and recommendations are unapproved or are not adequately followed up even if the requisite approval is forthcoming. Some spending ministries lack internal audit committees and/or audit charters and have not created an environment conducive to the operation of the internal audit function. Where this is the case, improper use of budget funds may escape detection with the result that budget funds are not executed as originally intended and are not contributing to the onset of development outcomes. Although interest tends to focus on the introduction of progressive audit functions, such as risk-based audits and performance (value-for-money) audits, if the basic internal audit function is not operating effectively, there is a strong possibility that more advanced auditing methods will not be practiced appropriately even if they are introduced. The cumulative effect of such practices contributes to wasteful, inefficient budget execution, which puts both the maintenance of aggregate fiscal discipline and the strategic allocation of resources at risk, in that budgets are not being allocated in accordance with national development plans. In addition to the foregoing, the failure of the internal audit process to turn up instances of improper spending within administrative organizations constitutes a major risk to efficient service delivery.

Implications for JICA projects

Where, for example, the recipient country does not have a well-functioning internal audit system complete with detailed implementation rules, there is a risk that funds earmarked for a project that is receiving JICA assistance will be used improperly under JICA project auspices, which, by extension, poses major reputational risks for JICA projects and for JICA per se.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) audit type; (2) the locus of accountability (who is accountable to whom); and (3) what, if any, follow-up mechanisms are in place, and what actions are being taken.

The following criteria are used to measure the progress of PFM reforms. The indicator looks at the internal audit functions of government as a whole, whether or not internal audit rules and guidelines have been developed, whether the various government organs have installed the internal audit committees necessary to support the internal audit process, the type of audits performed, the existence of reporting lines, the extent to which such lines are functioning effectively, whether audit committees discuss internal audit findings, and whether there are adequate follow-up mechanisms in place to track the progress of audit findings and recommendations.

Level	Contents
Level 4	Rules and guidelines for internal auditing for all government entities are established. An internal audit committee is established in all the ministries, departments, and agencies. Compliance audits, financial audits, and other types of internal audits are operational, practically following IIA (the Institute of Internal Auditors) standards. Risk-based audits have been introduced. Internal audit reports adhere to a fixed schedule are submitted to the finance ministry or the SAI periodically and deliberated by its audit committee. Based on audit results, action is prompt and comprehensive across central government entities.
Level 3	Rules and guidelines for internal auditing for all government entities are established. An internal audit committee is under establishment in half or more than half of the ministries, departments, and agencies. Compliance audits, financial audits, and other types of internal audits are operational by the majority of central government entities, practically following IIA (the Institute of Internal Auditors) standards. Risk-based audits have been partially introduced. Internal audit reports adhere to a fixed schedule are submitted to the finance ministry or the SAI periodically and deliberated by its audit committee. Based on audit results, action is prompt and comprehensive across central government entities in many cases.
Level 2	Rules and guidelines for internal auditing for all government entities are established. An internal audit committee is under establishment in each government entity. Compliance audits, financial audits, and other types of internal audits are operational by major central government entities, but they are not following IIA (the Institute of Internal Auditors) standards. Risk-based audits have been partially introduced. Internal audit reports are issued regularly for most government entities, but may not be submitted to the finance ministry and the SAI. Based on audit results, a fair degree of action is taken on major issues but often with delay.
Level 1	Rules and guidelines for internal auditing for all government entities are not established. An internal audit committee has not been established in most government entities. Even where a committee has been established, compliance audits and financial audits are not operational systematically. Internal audit reports are not issued, or are issued irregularly, and are insufficiently deliberated by its audit committee. The results are not reported, or are reported but action is not

	taken on the results.

Reference: Findings of tendencies from PEFA Indicators.

Since the above table is not wholly consistent with the relevant PEFA performance indicators, it is not possible to make a straightforward comparison of the respective parameters; for reference, the applicable PEFA performance indicator points to the following correlations (in terms of income levels).

- PI-21: Evidence of a degree of correlation.

4-16. Reporting

The disclosure to the general public of fiscal reports in appropriate formats and in a timely manner is a necessary condition for ascertaining information on the past and present finances and budget allocations of the recipient government and counterpart organizations and on the current state of the budget execution process.

Overview

In examining the PFM of a specific country, fiscal reports (reporting) are the cornerstone of aggregate fiscal discipline, strategic allocation of resources, and operational efficiency. Reporting is also critical in terms of transparency and accountability in the PFM system. It is a time-honored truism that fiscal reports are intended to "demonstrate the compliance of expenditure with the budget" (i.e., whether the budget is on track).

In many developing countries, however, expenditure is not always in compliance with the budget and the fiscal reports produced are not meeting their objectives in this respect. Broadly speaking, the fiscal reports published by governments can be divided into two types: in-year financial reports and annual final statements. These are released at daily, monthly, quarterly, or yearly intervals as appropriate, with the monthly reports containing data on the execution of the budget in the relevant month, including amounts that have yet to be disbursed. Annual final statements, meanwhile, are consolidated by the finance ministry on the basis of reports prepared by individual ministries and executing agencies, and reported to the Supreme Audit Institution (SAI). The number of months from the end of the fiscal year within which such reports must be submitted to the SAI is prescribed by applicable laws in individual countries.

Implications for the partner country

Even where fiscal reporting requirements, such as the types of reports and the timelines for their submission, are explicitly provided for in the organic budget law or fiscal responsibility law, problems may occur due to incompleteness, delays in submission, or lack of accessibility through appropriate means. Where this is the case, budget preparation work cannot be conducted on the basis of accurate fiscal information for the preceding financial year and it is not possible to check on actual budget performance in-year.

Implications for JICA projects

Where, for example, the laws and regulations on fiscal reporting have not been adequately developed, JICA will have no option but to rely on reports from the government relating to the actual budget performance of JICA projects. If, however, such reports cannot be obtained on a timely basis or the reports contain ambiguous information, it becomes difficult to ensure fund accountability using the recipient government's fiscal system.

Checkpoints for assessing progress of PFM reforms

At the bare minimum, the first task is to ascertain what reports are available for perusal. Having done this, the following are optional dimensions for assessing the progress of PFM reforms in this area: (1) public access to fiscal information; (2) the quality of in-year financial statements and the timing of their submission; and (3) the quality of final statements and the timing of their submission.
The following criteria are used to measure the progress of PFM reforms in this area. The indicators measure the degree to which public access to fiscal information is assured, the quality of in-year financial statements, and final statements, as well as whether such reports are submitted in adherence to a fixed schedule.

[Public access to fiscal information]

Level	Contents
Level 4	The government makes available to the public five or six of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.
Level 3	The government makes available to the public three or four of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.
Level 2	The government makes available to the public one or two of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.
Level 1	The government makes available to the public none of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.

Note: Equivalent to PEFA performance indicator PI-10.

[Quality and timeliness of in-year financial statements]

★ A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. Reports are prepared quarterly or more frequently, and issued within four weeks of end of period. There are no material concerns regarding data accuracy.
Level 3	Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages. Reports are prepared quarterly, and issued within six weeks of end of quarter. There are some

	concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/usefulness.
Level 2	Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). Reports are prepared quarterly (possibly excluding first quarter), and issued within eight weeks of end of quarter. There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
Level 1	Comparison to the budget may not be possible across all main administrative headings. Quarterly reports are either not prepared or often issued with more than eight weeks' delay. Data is too inaccurate to be of any real use.

Note: Equivalent to PEFA performance indicator PI-24.

[Quality and timeliness of final statements]

★ A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

Level	Contents
Level 4	A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities. The statement is submitted for external audit within six months of the end of the fiscal year. International Public Sector Accounting Standards (IPSAS) or corresponding national standards are applied for all statements.
Level 3	A consolidated government statement is prepared annually. It includes, with few exceptions, full information on revenue, expenditure, and financial assets/liabilities. The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year. IPSAS or corresponding national standards are applied.
Level 2	A consolidated government statement is prepared annually. Information on revenue, expenditure, and bank account balances may not always be complete, but the omissions are not significant. The statements are submitted for external audit within 15 months of the end of the fiscal year. Statements are presented in a consistent format over time with some disclosure of accounting standards.
Level 1	A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements, OR the financial records are too poor to enable auditing. If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year. Statements are not presented in a consistent format over time, OR accounting standards are not disclosed.

Note: Equivalent to PEFA performance indicator PI-25.

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trends. (Note: None of these trends is absolute, and these findings should not be taken as categorical.)

- PI-10: Evidence of a degree of correlation.
- PI-24: As above.
- PI-25: As above.

4-17. Financial Management Information System (FMIS)

An FMIS is essential for the proper and accurate recording of the accounting data of recipient countries.

Overview

Generally speaking, there are two systems that support the automation of PFM processes: a Financial Management Information System (FMIS) and the more advanced Integrated Financial Management Information System (IFMIS). Both are computer-based information systems that are designed to bundle the financial systems of governments and public entities. The majority of countries have an operative FMIS (i.e., information systems that monitor treasury accounts payable and accounts receivable), with an IFMIS being introduced as a replacement solution. An IFMIS is configured to deliver separate modules of fiscal information (e.g., covering budget preparation to budget execution, or revenue to execution), which are purchased by sub-national levels of governments, etc., as required. Accordingly, the first task is to identify which PFM processes (systems) are covered by the recipient country's FMIS. Again, since an IFMIS is designed to process accounts data, the integration of budget items and the chart of accounts is an essential prerequisite for the introduction of an IFMIS solution. An IFMIS also has embedded commitment controls that are necessary to ascertaining future expenditure.

Implications for the partner country

Since the introduction of FMIS solutions involves the automation of complex fiscal systems, their use demands high-level administrative capacity, while the procurement of these expensive systems can lead to massive corruption that has the potential to delay the PFM reform process as a whole.

Implications for JICA projects

Where, for example, JICA is implementing a Japanese ODA loan, it will be necessary to assess the recipient country's aggregate fiscal discipline arrangements and to look at current and future budget appropriations (estimates). It is also important to ascertain whether the counterpart organization in the recipient country is capable of disbursing the necessary funds in accordance with the agreed timetable. In such instances, it is unrealistic to expect individual expenditure commitments at a given point in time to be managed manually, and the treasury needs to be capable of functioning effectively in terms of commitment controls, etc., before work can commence. This will not be possible, however, if the recipient country does not have a well-functioning FMIS.

Checkpoints for assessing progress of PFM reforms

The following are possible dimensions for assessing PFM reforms in this area: how far along the IFMIS introduction process the recipient country is, and what arrangements have been made in terms of staff assignment and securing the necessary budgetary funding.

The following criteria are used to measure the progress of PFM reforms in this area. The indicator looks at whether the country has introduced and is operating a basic accounts system, and, where an IFMIS has been introduced, what functions are embedded and what organizations are covered by the system, how effectively the system is functioning, and what arrangements have been made in terms of staff assignment and securing the necessary budgetary funding.

It is worth noting that while the introduction of an IFMIS has been singled out as one of the leading causes of failure in donor support for PFM reforms, given that commitment control, cash management and other processes cannot feasibly be undertaken effectively as manual processes, the need for some form of automated system, even in low-income countries, needs to be appreciated.

Level	Contents
Level 4	All or partial IFMIS functions have been introduced in all entities of central government and most of them are operational. Human resources are well allocated to an IT department and financial resources for O&M are almost secured.
Level 3	All or partial IFMIS functions have been introduced in major entities of central government (big spenders) and most of them are operational. Human resources are partially allocated to an IT department and financial resources for O&M are secured to some extent.
Level 2	All or partial IFMIS functions have been introduced in some departments of major entities of central government (big spenders). Allocation of human resources to an IT department and financial resource for O&M are progressing.
Level 1	A basic accounting system has been introduced and is operational to some extent. Prerequisites for introducing an IFMIS (e.g., accounting items, accounting procedures and practices, human resources for IT department, financial resources for O&M, etc.) are not well satisfied.

Reference: Findings of tendencies from PEFA Indicators.

PEFA has not established an indicator for this area.

4-18. External Audits and Parliamentary Scrutiny

Audits/scrutiny by a legal entity/organization that is independent of the executive are essential to ensuring that the recipient government and counterpart organization are executing their budgets in conformity with the applicable laws and regulations.

Overview

Many countries conduct their external audits in the form of compliance and/or financial audits. Some countries are attempting to introduce value-for-money audits. The auditing of final accounts is a major part of the work undertaken by the Supreme Audit Institution (SAI; equivalent to the Board of Audit of Japan), which they use to confirm adherence with auditing standards and consistency between budget appropriations and actual expenditure. The audits conducted by the SAI do not stop at annual final statements; they include examinations of samples to check that the accounting methods used to generate these data are producing accurate data on the incomings and outgoings given in the government’s annual budget reports. In such instances, some of the audit work may be outsourced to a private-sector auditing organization due to SAI staffing constraints. In many countries, the number of months from the end of the fiscal year within which such statements must be submitted to the legislature is prescribed by the applicable laws. Accordingly, it is important to establish whether final statements are being appropriately audited for compliance and financial integrity, whether there are clear reporting lines for the submission of these statements to the legislature, the cabinet or other pre-determined body, and whether the statements are being submitted in a timely manner.

Implications for the partner country

In many developing countries, many months elapse before externally audited final statements are submitted to the legislature/cabinet for scrutiny, meaning that any problems identified go uncertified. Again, the habitual delays in the submission of externally audited final statements mean that the legislature has little incentive to undertake the additional examinations that are necessary to provide feedback on expenditure outcomes, with the result that only simple ex-post checks are performed. In addition, many developing country governments do not have the capacity needed for a full analysis of their final statements.

Implications for JICA projects

Where, for example, the recipient country does not have a well-functioning external audit system complete with detailed implementing rules, there is a risk that funds earmarked for a project that is receiving JICA assistance will be used improperly under JICA project auspices, which, by extension, poses major reputational risks for JICA projects and for JICA in itself.

Checkpoints for assessing progress of PFM reforms

The following are optional dimensions for assessing the progress of PFM reforms in this area: (1) audit type; (2) the locus of accountability (who is accountable to whom); and (3) what, if any, follow-up mechanisms are in place, and what actions are being taken.

The following criteria are used to measure the progress of PFM reforms. The indicator looks at the external audit functions of government as a whole, whether or not external audit rules and guidelines have been developed, whether the various government organs have installed the external audit committees necessary to support the external audit process, the type of audits performed, the existence of reporting lines, the extent to which such lines are functioning effectively, whether audit committees discuss audit findings, and whether there are adequate follow-up mechanisms in place to track progress on audit findings and recommendations.

A score of Level 2 and above indicates the core level of PFM functionality given in Figure 8 has been reached.

[Scope and nature of audits performed]

Level	Contents
Level 4	All entities of central government are audited annually covering revenue, expenditure, and assets/liabilities. A full range of financial audits and some aspects of performance audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues.
Level 3	Central government entities representing at least 75% of total expenditures are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues.
Level 2	Central government entities representing at least 50% of total expenditures are

	audited annually. Audits predominantly comprise transaction-level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.
Level 1	Audits cover central government entities representing less than 50% of total expenditures or audits have higher coverage but do not highlight the significant issues.

Note: Equivalent to PEFA performance indicator PI-26.

[Timeliness of submission of audit reports to legislature and evidence of follow-up on audit recommendations]

Level	Contents
Level 4	Audit reports are submitted to the legislature within four months of the end of the period covered and in the case of financial statements, from their receipt by the audit office. There is clear evidence of effective and timely follow-up.
Level 3	Audit reports are submitted to the legislature within eight months of the end of the period covered and in the case of financial statements, from their receipt by the audit office. A formal response is made in a timely manner, but there is little evidence of systematic follow-up.
Level 2	Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements, from their receipt by the auditors). A formal response is made, though delayed or not very thorough, but there is little evidence of any follow-up.
Level 1	Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audits of financial statements, from their receipt by the auditors). There is little evidence of response or follow-up.

Reference: Findings of tendencies from PEFA Indicators.

An analysis of the PEFA indicators in terms of income levels reveals the following trend. (Note: The trend is not absolute, and the finding should not be taken as categorical.)

- PI-26: Evidence of a degree of correlation.

For reference, the International Organization of Supreme Audit Institutions (INTOSAI), which operates as an umbrella organization for the external government audit community in both advanced and developing nations, has developed a framework for measuring the performance of the SAI. The pilot version of this performance measurement framework was released in January 2014.

SAI Performance Measurement Framework
http://www.idi.no/artikkel.aspx?MId1=102&AId=704

Part III. A Practical Guide to PFM

POINTS

This section classifies the Key Questions under three headings, “some information desirable,” “more information desirable,” and “specific information desirable,” in order to effectively conduct the process of information gathering and analysis during interviews with finance ministry officials and other donors in partner country governments on progress towards Public Financial Management (PFM) reform. Through the careful selection of the level of questioning based on the purpose of and time available for interviews, users of this Handbook will realize the following benefits.

- It allows interviewers to plan their interviews effectively by selecting ahead of time which of the Key Questions they intend to ask, etc.
- Concentrating on a set of well-targeted Key Questions makes for a more efficient and effective interview process. It also means that analytical reports can be tailored to purpose.

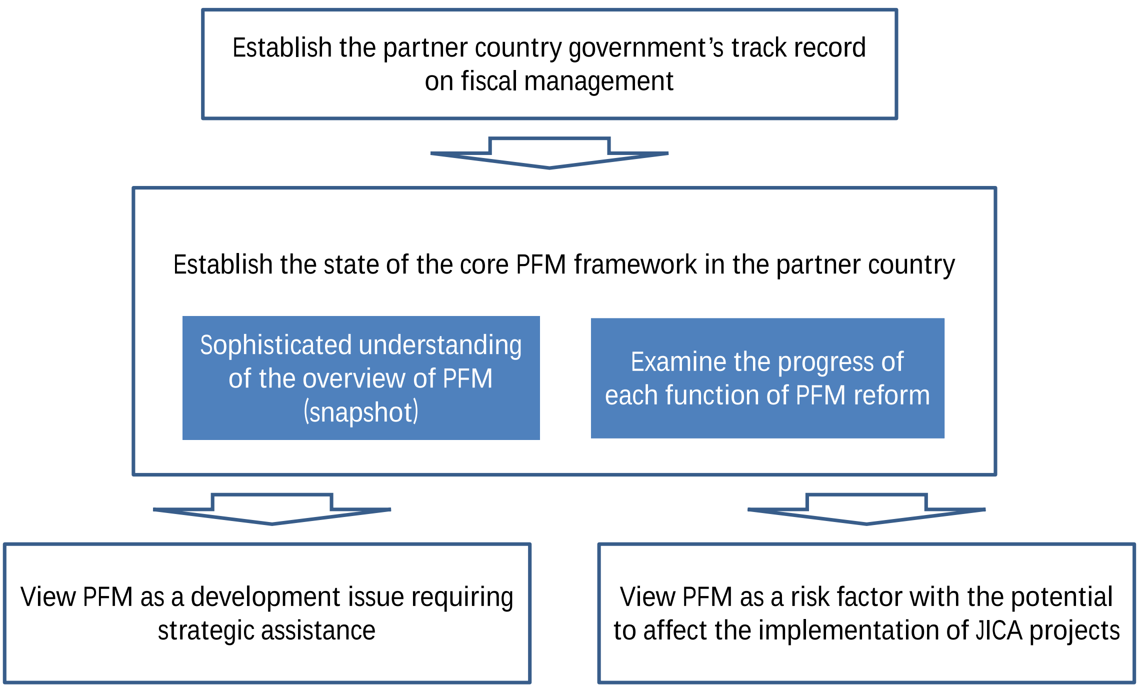
Additionally, where the process involves attending donor conferences on PFM reform, having a mental list of Key Questions that correspond to your awareness of the issues at hand as you listen to the discussions can be expected to facilitate your consideration and understanding of the various issues. Similarly, having a mental list of Key Questions in your head as you read the literature on PFM will make it easier to isolate the relevant information.

Chapter 5. Tracking the Progress of PFM Reforms

Given that PFM is a core capacity within the recipient country's institutional framework, readers are encouraged to start by getting a firm grip on the current status of PFM in the recipient country, whichever of the two principles cited in "2.1 Awareness of the PFM Issue" underpins their approach to PFM work. In doing this, it seems sensible to pick up on the key terms that are referred to by numerous donor organizations, such as MTEF, program budgeting, and IFMIS, as a starting point in the process of gathering background information, rather than focusing on the specifics of individual PFM functions. This should facilitate an understanding of the discussions on the various PFM functions in speeches made by recipient government officials and donor conferences in the country, and once this basic information has been acquired, it will then be possible to begin the work of assessing the status of individual PFM functions (e.g., budget preparation and execution, accounting, procurement, reporting, audits, etc.).

Having put the recipient's PFM system into perspective, the next task is to think about what actions JICA needs to take, if any; i.e., whether JICA should be providing strategic assistance for particular PFM functions as an essential part of the development process, or whether JICA needs to view the recipient country's PFM system as a potential risk factor for the implementation of specific projects. (For details, readers are referred to the JICA Position Paper on Public Financial Management of February 2013 and the checklist contained in the thematic evaluation report from An Inquiry into Good Practice in Public Financial Management by Developing Country Governments to Ensure the Sustainability of Development Outcomes [in Japanese, provisional title], which was completed in January 2014.)

Figure 17: Desirable Approaches to PFM



5-1. Getting a Snapshot of PFM System Performance

When understanding the PFM system of a recipient country, JICA needs to comprehend the various facts outlined in Figure 18 as a bare minimum for their PFM work. There are several common keywords that are used by recipient government officials and other donors in the PFM dialogue, and keywords that will be of interest to visiting JICA personnel. Readers are thus advised to familiarize themselves with these keywords in order to be able to respond promptly to such inquiries from visiting personnel.

Figure 18: The Bare Minimum You Should Know (A PFM Snapshot)

The terms and concepts listed below are used as standard by donor organizations in their discussions on PFM reform programs.

Item	The bare minimum you should know
PFM reform program	Is the reform program up and running? What is the partner government's assessment of it? What is the assessment of donor's reform? What level of government is in control of the PFM reform process? (Is the president or prime minister in charge? If it's the finance ministry, which official/department has responsibility?)
PER/PEFA diagnostics	Have the diagnostics been performed? What assessment was made? Are there plans to undertake the diagnostic process?
Budget preparation methods	Does the government use incrementalism in budgeting or a performance budget?
Medium-term perspectives in budgeting	Does the government use the Medium-Term Expenditure Framework (MTEF)? Is there a separate public spending plan? What discussion is there on integration of the two?
Budget preparation process	When does the financial year start and end? When does the budget preparation work start and what does it involve?
	Is the timing of the JCC and interim review and/or terminal evaluation of JICA projects synchronized with the counterpart budget preparation process in the partner country?
Budget allocation, budget execution	How does the budget allocation/execution process work? What, if anything, delays the budget allocation/execution process? Had the budget for the current year been more-or-less executed by the last two months of the financial year?
Internal audits, external audits	What type of auditing does the government favor? Who does it report to and what follow-up is involved? If external audits are conducted, what level of interest do they generate in parliament, CSO, the media?
Integrated Financial Management Information System (IFMIS)	Has an IFMIS been introduced? What coverage does it have?

Here, the column dealing with the budget preparation process includes information on whether the timing of the JCC (Joint Coordination Committee) and interim review and/or terminal evaluation of

JICA projects is synchronized with the budget preparation process in the recipient country, since this is relevant to the implementation of such projects.

5-2. Tracking Progress on PFM Reforms by Function

Where it is necessary to address the needs listed below independently of the PFM snapshot shown in Figure 18, it may be necessary to collect and analyze data on PFM in the recipient country.

- Where there is a need for a briefing report on PFM in the recipient country.
- Where there is a need for a country-specific analysis or surveys on upstream variances in the PDCA cycle (a basic fact-finding survey or preparatory survey for project formulation).
- Where there is a need for PFM diagnostics and/or a project review.

The following section offers a practical perspective on the planning and conduct of PFM interviews with particular emphasis on maximizing efficiency in the interview process from the perspective of addressing the specific goals listed above.

Conducting interviews on PFM with a view to addressing specific goals

[Step 1] Get a rough idea of progress toward PFM reforms

When interviewing, the first task is to get a rough idea of what progress the recipient country (or counterpart organization) has made on PFM reforms. To achieve this, questions need to be framed around the key terms and concepts that are used to assess progress on the work of improving the various PFM functions (e.g., budgeting, treasury, execution, accounting rules, audits, etc.).

It seems likely that many of those who claim to have no understanding of the current status of PFM system performance in a recipient country feel this way because they are uncertain of the dimensions that should inform their assessment or of how in-depth this assessment needs to be. Such readers are referred to the Matrix for Measuring Progress on PFM Reforms presented in Appendix 1 as a useful starting point. JICA has prepared documents on tax administration, the US-based Institute of Internal Auditors (IAA) has prepared documents on the internal audit process, and INTOSAI has developed a framework for measuring the performance of external audit firms. These documents are presented in the second half of Appendix 1.

Where a Country Report on a PEFA-based PFM assessment is available, readers are encouraged to mechanically transfer the indicator scores from the PEFA assessment reports (A, B, etc.) to the matrix. The matrix is designed such that it can be color coded in about five minutes because the majority of the parameters used are compatible with the indicators used in PEFA diagnostic work. Where no PEFA Country Report is available, interview questions should be framed around the keywords listed in the table entitled "Perspectives" in Appendix 1 and put to the interviewee in a well-paced manner to get the requisite information on PFM reform progress. A Microsoft Excel version of Appendix 1 is available to facilitate the color-coding process.

Where the interviewee is a member of a department with jurisdiction over specific PFM functions, i.e., treasury or accounting, etc., as opposed to a member of a finance ministry PFM reform program unit, the Key Questions should be narrowed down accordingly.

[Step 2] Get specific information on the current status of individual PFM functions

<u>Once you have a broad-based picture of progress towards PFM reforms in the recipient country, the next step is to select which category of information is best suited to your specific goals, based on the purpose of the interview and the time available to you for conducting it: "Some Information Desirable," "More Information Desirable," or "Specific Information Desirable."</u> The List of Key Questions presented in Appendix 2 is designed to facilitate the interview planning process and the efficient conduct of PFM interviews, and should be used to formulate a list of questions to be asked during the interview, thereby expediting the planning process. The following offers a guide to selecting the correct interview category.

Interview Category	First Indicator (Purpose of Interview)	Second Indicator (Time Available)
Some information desirable	Preparation of a briefing report on PFM in the partner country	1 hour
More information desirable	Preparation of a country-specific analysis or surveys on upstream variances in the PDCA cycle (a basic fact-finding survey or preparatory survey for cooperation)	2 hours
Specific information desirable	PFM diagnostics, project review	More than 2 hours

Source: Basic Information Necessary to Formulating Interview Plans and Conducting PFM Interviews

In fact, few people are capable of understanding at a glance what can be gained by asking government officials in the recipient country the Key Questions on PFM functions (e.g., budgeting, treasury, execution, accounting rules, audits, etc.). To understand these questions without additional input you would need to have an academic or practical background in PFM plus considerable experience in this field.

For the large majority who do not possess an academic or practical background in PFM nor have extensive experience in PFM work, in order to be able to formulate effective interview plans and use these as the basis for conducting their PFM interviews and analyzing the findings gained from them, the following points should be seen as essential to the interview process.

- Apprehending the bottlenecks to the smooth implementation of JICA projects and the sustainability of aid effectiveness and development outcomes (see Figure 19).
- Sorting out which of the bottlenecks are related to PFM in the recipient country (see Figure 20).
- Classifying these bottlenecks according to the PFM function to which they relate (e.g., budgeting, treasury, execution, accounting rules, audits, etc.) (see Figure 21).
- Next, determining what defects in PFM functions (e.g., budgeting, treasury, execution, accounting rules, audits, etc.) have the potential to impede the smooth implementation of JICA projects and the sustainability of aid effectiveness and development outcomes (see Figure 21).

Once an interviewer has succeeded in organizing the key points to the interview process, each of the seemingly innocuous Key Questions will rapidly take on meaning during the planning and conduct of PFM interviews.

Figure 19: Risks to JICA Project Implementation

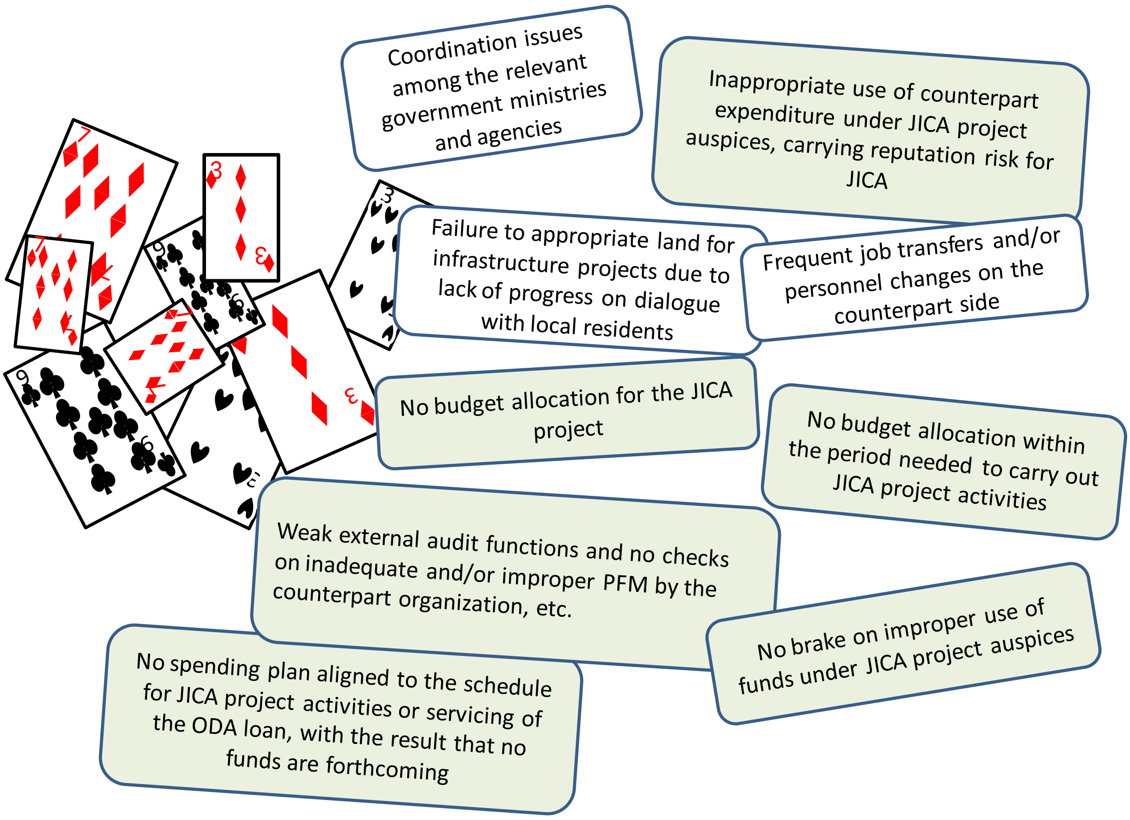


Figure 20: Risk Factor Classification

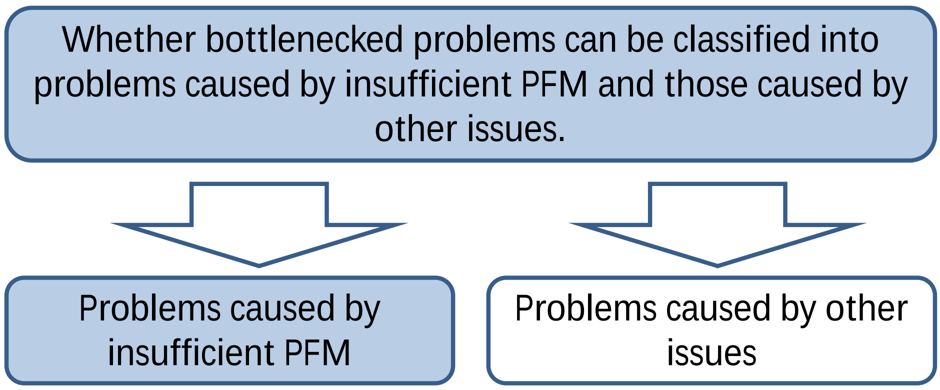
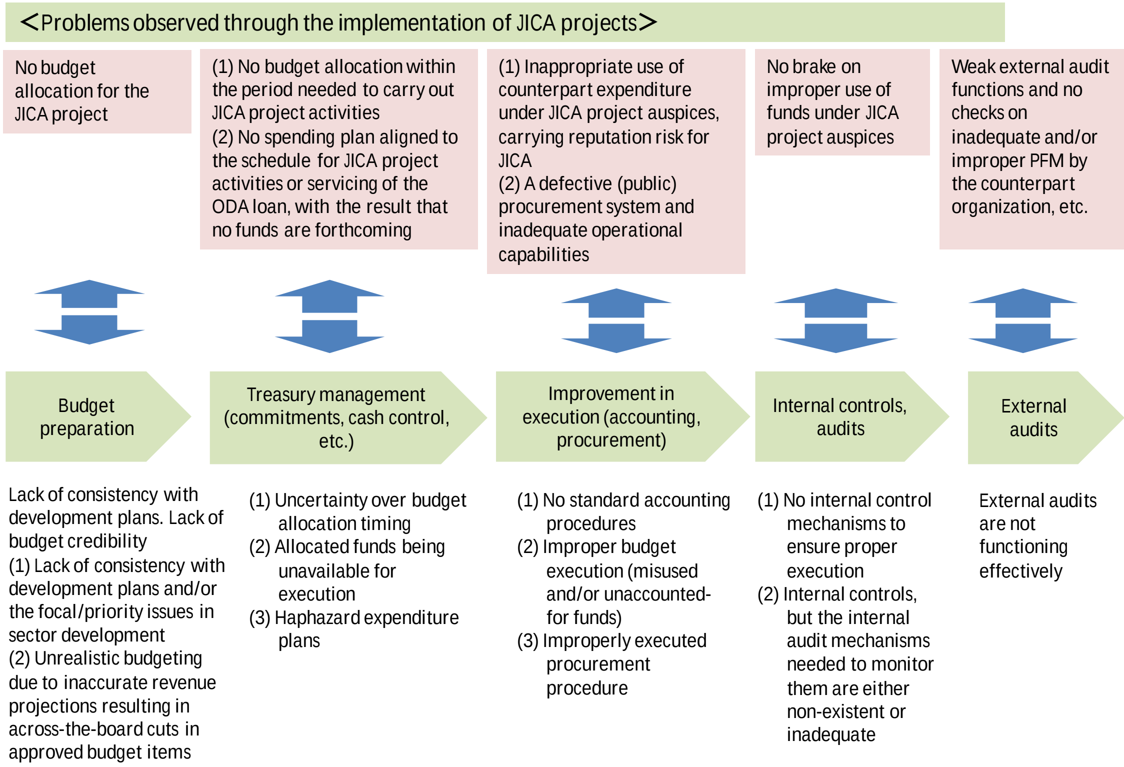


Figure 21: Correlating the Risks to JICA Projects to Respective PFM Functions (repeated)



[Step 3] Document your findings (on the current state of PFM system performance in the recipient country)

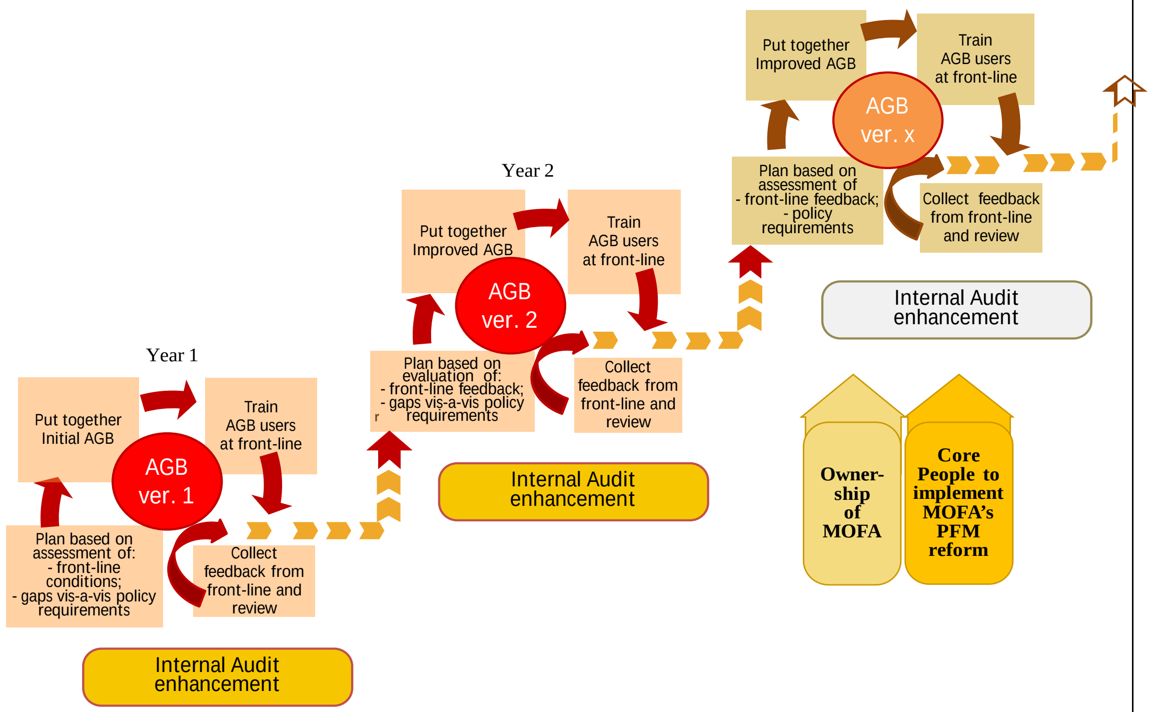
Document your findings according to the type of interview you are conducting. Sample reports are given in Appendix 3. In documenting interview findings on the basis of the materials presented in Appendix 1, the report will likely focus on the current status of respective PFM functions and call attention to specific issues, but it is also important to include information on the non-technical aspects of the PFM process discussed in 4-1: Leadership and Motivation of PFM Reform in the Country.

[Column] Giving meaning to JICA assistance projects within the context of a medium- to long-term PFM reform roadmap

PFM is an essential part of the development process. It is an issue that relates both to core administrative systems in the recipient country and to issues that are influenced by non-technical determinants external to PFM that are recognized as critical to the success of reform. This means that it is essentially unrealistic to expect PFM assistance to bear fruit in the short to medium term.

Accordingly, our task is to visualize a medium- to long-term roadmap towards PFM reforms, to identify what stage the recipient country has reached in the PFM reform process, and to think about what stage in that process the targets of the country's PFM reform program will allow it to progress to.

Where, for example, a line ministry (Ministry A) in a certain country has not developed a standardized financial accounting manual, its departments and regional offices will all be using divergent accounting procedures. In this instance, it would be useful to design a JICA technical assistance project that has the development of a financial accounting manual as its goal. The implications for project formulation will differ substantially depending on whether the country has a standardized financial accounting manual and whether the central and regional departments of Ministry A are putting standardized accounting procedures into practice based on the standardized financial accounting manual in the context of that country's medium- to long-term PFM reform roadmap, and whether its financial accounting manual has been developed in isolation.



The outcomes of PFM assistance may not be visible in the short to medium term, but, from the former perspective, the impact on JICA project outcomes is significant all the same.

The color-coded table on progress towards PFM reforms in recipient countries given in the Matrix for Measuring Progress on PFM Reforms (Appendix 1) offers useful pointers on the significance of JICA project assistance in the context of a specific country's medium- to long-term roadmap for PFM reforms.

Source: Taken from PFM Capacity Building Seminar held in November 2013 (Introductory Seminar (2) Materials for the Presentation on Case Study Reporting), Koei Research Institute (KRI International Corporation).

Part IV. Challenges for the Future

Chapter 6. Challenges for the Future

The following are challenges to be addressed by those seeking to further enhance their PFM literacy and to link this to practical action in the field. Going forward, it is hoped that, in addition to JICA personnel, interested parties from the world of Japanese academia and other researchers, among others, will deepen their knowledge of PFM.

Challenge 1: Enhance and strengthen case studies on the PFM systems of developing countries

As has been emphasized throughout this Handbook, irrespective of the differences between developing countries and major industrial powers, PFM reforms are essentially dynamic processes, while the information obtained using the PEFA diagnostic tools and the Matrix for Measuring Progress on PFM Reforms presented in this Handbook is static, as opposed to the technical data that emerges from field research. Conducting an assessment of PFM system performance in a recipient country provides an opportunity to consider the various dimensions of the reform process as a whole: the necessity for the recipient country to engage more strongly with its PFM reforms, the political motivation for reform, and the fact that the PFM reform process covers a vast array of functions; and ultimately to take a comprehensive look at how this reform process can be linked to the budgetary outcomes (aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery) and the fiscal and expenditure policies and goals listed in Chapter 3, Figure 4.

In this sense, the areas covered by this Handbook do no more than describe the process of obtaining a snapshot of a recipient country's progress on PFM reforms, which means that the task of elucidating the assessment methods needed in considering the links between this snapshot and budgetary outcomes and fiscal and expenditure policy and goals, and the direction of PFM reforms going forward (i.e., the design of the PFM reform process), remains to be done.

Looking ahead, the accumulation of relevant cases will be essential to research on the PFM reform experience of various countries around the world.

Challenge 2: Coordinate Japanese knowledge and experience of input controls in budget preparation and management in a systematic way

The incorporation of a medium-term perspective and performance-based budgeting into the budget preparation process constitutes a recent trend in the PFM reform work that is being conducted in developing countries. For this to happen, however, the developing country must have firm control on its inputs. This matter was addressed by University of Maryland Professor Allen Schick in his keynote speech at the Centre for Aid and Public Expenditure (CAPE) Conference 2013 on Budgeting in the Real World, which was hosted by the Overseas Development Institute (ODI) at its offices in the U.K. in November 2013.[9]

There are, however, few solid research findings on input control in budgeting. This aspect of the budgeting process was touched upon in "4-8. Performance Evaluation in the Budgeting Process" in Chapter 4 of this Handbook, but the information provided herein is by no means sufficient.

Given that Japan and the other advanced nations of the world have accumulated a substantial store of

[9] The link to Professor Schick's presentation is given for reference: http://www.youtube.com/watch?v=mtXV0E13rfU

practical know-how on input controls, there is a need for research into methods to facilitate the systematic ordering of this knowledge.

Appendix 1: Matrix for Measuring Progress on PFM Reforms

PFM function	Assessment point	PEFA indicators	PFM core standard (indicative)	Criteria for Progress on PFM Reforms			
				Level 1 (PEFA=D)	Level 2 (PEFA=C)	Level 3 (PEFA=B)	Level 4 (PEFA=A)
01. Legislative and Institutional Budgetary Frameworks	Written basic principles, basic rules, and authorities of PFM; procedures of compliance	-	-	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are not established.**	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established, but organizational settings do not exist.**	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established and organizational settings exist. But those have not become conscious.**	PFM related laws and regulations are established and basic functions of PFM and its supervisory authorities are specified. **Rules** concerning fiscal discipline **are established and organizational settings exist. Those have become conscious.**
02. Budget Credibility and Execution	Variance in the original budgeted expenditure and final accounts	1	-	**In two or all of the last three years** the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 15%** of budgeted expenditure.	**In no more than one of the last three years** has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to **more than 15%** of budgeted expenditure.	**In no more than one out of the last three years** has the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 10%** of budgeted expenditure.	**In no more than one out of the last three years** has the actual expenditure deviated from budgeted expenditure by an amount equivalent to **more than 5%** of budgeted expenditure.
	Variance in expenditure composition between the budgeted expenditure and	2	2(i) B (indicative)	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 15% in at least two of the last three**	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 15% in no more than one of the**	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 10% in no more than one of the last**	**Variance** in expenditure composition (administrative) between the budgeted expenditure and actual expenditure **exceeded 5% in no more than one of the**

	actual expenditure			**years.**	**last three years.**	**three years.**	**last three years.**
	Variance in aggregate revenue out-turn and original approved budget	3	-	Actual domestic revenue was below 92% or above 116% of budgeted domestic revenue **in two or all of the last three years.**	Actual domestic revenue was between 92% and 116% of budgeted domestic revenue **in at least two of the last three years.**	Actual domestic revenue was between 94% and 112% of budgeted domestic revenue **in at least two of the last three years.**	Actual domestic revenue was between 97% and 106% of budgeted domestic revenue in at least two of the last three years.
	Stock of arrears	4	4(ii) B or above	The stock of arrears **exceeds 10%** of total expenditure. **There is no reliable data** on the stock of arrears **from the last two years.**	The stock of arrears constitutes **2-10%** of total expenditure, and **there is no evidence that it has been reduced significantly in the last two years.** Data on the stock of arrears has been generated by at least one comprehensive **ad hoc exercise** within the last two years.	The stock of arrears constitutes **2-10%** of total expenditure, and there is evidence that **it has been reduced significantly** (i.e., more than 25%) **in the last two years.** Data on the stock of arrears is **generated annually,** but **may not be complete** for a few identified expenditure categories or specified budget institutions.	The stock of arrears is low (i.e., is **below 2%** of total expenditure). **Reliable** and complete data on the stock of arrears is generated through routine procedures at least **at the end of each fiscal year** (and includes an age profile).
03. Budget Comprehensiveness	Coverage of budget and its discipline	7	B or above	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 10% or more of total expenditure. Rules** to manage extra-budgetary expenditure (equivalent to general budget) **are not established or not widely understood.**	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 5-10% of total expenditure. Minimum basic rules** to manage extra-budgetary expenditure (equivalent to general budget) **are established and applied to main extra-budgetary funds.**	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **constitutes 1-5% of total expenditure. Rules** to manage extra-budgetary expenditure **(equivalent to general budget) are established and cover most of the operation of extra-budgetary funds.**	**The level of unreported extra-budgetary expenditure,** which should be covered in budgeted expenditure, in-year budget reports, and final accounts, **is insignificant (below 1% of total expenditure). Rules** to manage extra-budgetary expenditure (equivalent to the general budget) **are established and cover all of the operation of**

							extra-budgetary funds.
04. Budget Classification (*)	Application of GFS and its level	5	C or above	Budget formulation and execution are based on a different classification (e.g., **not GFS-compatible** or **with administrative break-down only**).	Budget formulation and execution are **based on administrative, and economic classifications** using GFS standards.	Budget formulation and execution are **based on administrative, economic, and functional classifications** (**using at least the 10 main COFOG functions**).	Budget formulation and execution are **based on administrative, economic, and sub-functional classifications**, using GFS/COFOG standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional classification.)
05. Budget Preparation Methods and Budget Allocation (*)	Existence of and adherence to a fixed budget calendar	11(i)	B or above	**A budget calendar is not prepared OR it is generally not adhered to OR the time** it allows for MDAs' budget preparation **is clearly insufficient to make meaningful submissions.**	**An annual budget calendar exists, but is rudimentary, and substantive delays may often be experienced** in its implementation, and it allows MDAs **so little** time to complete detailed estimates that **many fail to complete them on a timely basis.**	**A clear annual budget calendar exists, but some delays are often experienced** in its implementation. The calendar allows MDAs reasonable time (**at least four weeks** from receipt of the budget circular) so that **most of them are able to meaningfully complete their detailed estimates on time.**	**A clear annual budget calendar exists**, is generally adhered to, and allows MDAs enough time (and **at least six weeks** from receipt of the budget circular) **to meaningfully complete their detailed estimates on time.**
	Effective budget ceilings	11(ii)	B or above	**A budget circular is not issued** to MDAs **OR** the quality of the circular is very poor **OR** cabinet is involved in approving the allocations only immediately before	**A budget circular is issued** to MDAs, including ceilings for **individual administrative units or functional areas.** The budget estimates are reviewed and approved by	**A comprehensive and clear budget circular is issued** to MDAs, which reflects ceilings approved by cabinet (or equivalent). This approval takes place after the circular	**A comprehensive and clear budget circular is issued** to MDAs, which reflects ceilings approved by cabinet (or equivalent) prior to the circular's distribution

				submission of detailed estimates to the legislature, thus **having no opportunities for adjustment.**	cabinet only after they have been completed in all details by MDAs, thus **seriously constraining cabinet's ability to make adjustments.**	distribution to MDAs, but before MDAs have completed their submission.	to MDAs.
	Timely budget approval by the legislature	11(iii)	B or above	The budget has been approved **with more than two months' delay** in two of the last three years.	The legislature has, in two of the last three years, approved the budget **within two months of the start of the fiscal year.**	The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.	The legislature has, during the last three years, approved the budget before the start of the fiscal year.
	Legislative scrutiny of the annual budget (procedure/timing)	27	B or above	The legislature's review is non-existent or extremely limited, OR there is no functioning legislature. **Procedures for the legislature's review are non-existent or not respected. The time allowed for the legislature's review is clearly insufficient for a meaningful debate** (significantly less than one month). **Rules regarding in-year budget amendments may exist** but are either very rudimentary or unclear, OR **they are usually not respected.**	The legislature's review covers **details of expenditure and revenue**, but only at a stage where detailed proposals have been finalized. Some procedures exist for the legislature's budget review, but **they are not comprehensive and only partially respected.** The legislature has **at least one month to review the budget proposals. Clear rules exist, but they may not always be respected** OR **they may allow extensive administrative reallocation as well as expansion of total expenditure.**	The legislature's review covers fiscal policies and aggregates for the coming year **as well as detailed estimates of expenditure and revenue. Simple procedures exist for the legislature's budget review and are respected.** The legislature has **at least one month to review the budget proposals.** Clear rules exist for in-year budget amendments by the executive, and **are usually respected**, but **they allow extensive administrative reallocations.**	The legislature's review covers fiscal policies, medium-term fiscal framework, and medium-term priorities **as well as details of expenditure and revenue. The legislature's procedures for budget review are firmly established and respected.** The legislature has **at least two months to review the budget proposals.** Clear rules exist for in-year budget amendments by the executive, **set strict limits** on the extent and nature of amendments, and **are consistently respected.**

06. Medium-Term Perspectives in Budgeting (*)	Accuracy of macro-economic forecasts	12(i)	C or above	**No forward estimates** of fiscal aggregates are undertaken.	**Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.**	**Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained.**	**Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained.**
	Scope and frequency of DSA	12(ii)	C or above	**No DSA** has been undertaken in the last three years.	**A DSA at least for external debt** has been **undertaken once** during last three years.	DSA for **external and domestic debt** has been **undertaken at least once** during the last three years.	DSA for **external and domestic debt** has been **undertaken annually** during the last three years.
	Linkages between investment budgets and recurrent budgets	12(iii)	C or above	Budgeting for investment and recurrent expenditure are **separate processes** with no recurrent cost estimates being shared.	Many investment decisions have **weak links** to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.	**The majority of important investments are selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.**	**Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.**
07. Consideration of Performance Evaluation during	Performance budget procedures and applicability	-	-	**There is not an effective performance evaluation system** intended for performance budgets. Based	**There is a performance evaluation system for performance budgets. Based on performance information,**	**There is a performance evaluation system for performance budgets. Based on performance information,**	**There is a performance evaluation system for performance budgets. Based on performance**

Budget Preparation (*)				on performance information, performance evaluation is conducted by all the ministries and agencies (e.g., a result-chain system and effective indicators are not introduced).	**performance evaluation is conducted by major ministries and agencies. The results are reported but not used as intended.**	**performance evaluation is conducted by major ministries and agencies. The results are reported to the public. The results are used depending on the type of performance budget.**	**information, performance evaluation is conducted by all the ministries and agencies. The results are reported to the public. The results are used depending on the type of performance budget. Internal audits and external audits consider the results.**
08. Cash Management and Planning, and Disbursement (*)	Frequency of government cash balance calculations	17(ii)	B or above	**Calculation of balances takes place irregularly.**	**Calculation and consolidation of most government cash balances take place at least monthly.**	**Most cash balances are calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement.**	**All cash balances are calculated daily and consolidated.**
	Frequency of bank reconciliations	22(ii)	B or above	**Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently.**	**Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year.**	**Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period.**	**Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period.**
	Cash management	16(i)	C or above	**Cash flow planning and monitoring are not undertaken or are of very poor quality.**	**A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated.**	**A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows.**	**A cash flow forecast is prepared for the fiscal year, and updated monthly on the basis of actual cash inflows and outflows.**
	Accuracy of information on commitment ceilings and	16(ii)	C or above	MDAs are provided commitment ceilings **for less than a month OR no reliable indication** at all of actual	MDAs are provided reliable information **for one or two months in advance.**	MDAs are provided reliable information on commitment ceilings **at least quarterly in advance.**	MDAs are able to plan and commit expenditure for **at least six months in advance** in accordance with the

	commitment rules			resource availability for commitment.			budgeted appropriations.
	Frequency and transparency of in-year adjustments to budget allocations	16(iii)	C or above	Significant in-year budget adjustments are **frequent** and not done **in a transparent manner.**	Significant in-year budget adjustments are **frequent**, but undertaken **with some transparency.**	Significant in-year adjustments to budget allocations take place **only once or twice in a year** and are done **in a fairly transparent way.**	Significant in-year adjustments to budget allocations take place **only once or twice in a year** and are done **in a transparent and predictable way.**
09. Debt Management (*)	Accuracy of debt data recording	17(i)	B or above	Debt data records are **incomplete** and **inaccurate to a significant degree.**	**Domestic and foreign debt records are complete, updated,** and reconciled **at least annually.** Data quality is considered to be **fair**, but **some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally** or with limited content.	**Domestic and foreign debt records are complete, updated,** and reconciled quarterly. Data are considered to be **of a fairly high standard**, but **minor reconciliation problems occur. Comprehensive management and statistical reports** (covering debt service, stock, and operations) **are produced at least annually.**	**Domestic and foreign debt records are complete, updated,** and **reconciled on a monthly basis** with data considered to be **of high integrity. Comprehensive management and statistical reports** (covering debt service, stock, and operations) **are produced at least quarterly.**
	Frequency and quality of monitoring of sub-national levels of government, autonomous government agencies, and public enterprises	9	B or above	**No annual monitoring of AGAs and PEs takes place,** or it is **significantly incomplete. No annual monitoring of SN governments' fiscal position takes place** or it is **significantly incomplete.**	Most major AGAs/PEs **submit fiscal reports** to central government **at least annually**, but a consolidated overview is missing or **significantly incomplete. The net fiscal position is monitored at least annually** for the most important level of SN government, but a	All major AGAs/PEs **submit fiscal reports** including audited accounts to central government **at least annually**, and central government consolidates overall fiscal risk issues into a report. **The net fiscal position is monitored at least annually** for the most important level of SN government, and central	All major autonomous government agencies (AGAs)/ public enterprises (PEs) **submit fiscal reports** to central government **at least six-monthly**, as well as annual audited accounts, and central government consolidates **fiscal risk issues into a report at least**

					consolidated overview is missing or **significantly incomplete.**	government consolidates **overall fiscal risk into a report.**	**annually. The net fiscal position is monitored at least annually** for all levels of sub-national (SN) government and central government consolidates **overall fiscal risk into annual (or more frequent) reports.**
	Maintenance of discipline over the contracting of loans and the issuance of guarantees	17(iii)	B or above	Central government's contracting of loans and issuance of guarantees are approved by different government entities, **without a unified overview mechanism.**	Central government's contracting of loans and issuance of guarantees are always approved **by a single responsible government entity**, but are **not decided on the basis of clear guidelines, criteria, or overall ceilings.**	Central government's contracting of loans and issuance of guarantees are made **within limits for total debt and total guarantees**, and always approved **by a single responsible government entity.**	Central government's contracting of loans and issuance of guarantees are made **against transparent criteria and fiscal targets,** and always approved by a single responsible government entity.
10. Asset Management	Frequency and accuracy of asset data recording	-	-	Recording of asset data is **not complete and considerably inaccurate.**	Recording of asset data is **complete and updated.** Records of asset data in an asset ledger and the actual amounts are **reconciled at least once a year**, but **a gap exists.** There are no material concerns regarding data accuracy. The **record of asset data is published on an ad-hoc basis.**	Recording of asset data is **complete and updated.** Records of asset data in an asset ledger and the actual amounts are **reconciled quarterly**, but **a gap exists.** There are no material concerns regarding data accuracy. The **record of asset data is published at least once a year.**	Recording of asset data is **complete and updated.** Records of asset data in an asset ledger and the actual amounts are **reconciled quarterly. There are no material concerns regarding data accuracy and its reconciliation.** **The record of asset data is published at least once a year.**
11. Revenue Management		-	-	(Note) Use the matrix produced as a collaboration between the National Tax Agency and JICA.			
12.	Development and	20(ii)(ii	B or	Internal control rules and	Internal control rules and	Internal control rules and	Internal control rules and

Accounting System and Procedures	practice of accounting procedures	i)	above	procedures consist of a basic set of rules for processing and recording transactions, which are **not controlled.**	procedures consist of a basic set of rules for processing and recording transactions, which are **understood** by those directly involved in their application. **Some rules and procedures may be excessive**, while **controls may be deficient in areas of minor importance.**	procedures incorporate a comprehensive set of controls, which are **widely understood,** but **may in some areas be excessive** (e.g., through duplication in approvals) and **lead to inefficiency in staff use and unnecessary delays.**	procedures are relevant, and incorporate a **comprehensive and generally cost effective** set of controls, which are **widely understood.**
	Scope and effectiveness of expenditure commitment rules	20(i)	B or above	Commitment control systems are **generally lacking** OR they are **routinely violated.**	Expenditure commitment control procedures **exist and are partially effective**, but they **may not comprehensively cover all expenditures** or they may occasionally be violated.	Expenditure commitment controls are **in place and effectively limit commitments to actual cash availability** and approved budget allocations for most types of expenditure, **with minor areas of exception.**	Comprehensive expenditure commitment controls are **in place and effectively limit commitments to actual cash availability** and approved budget allocations.
13. Public Procurement	Comprehensiveness and competitiveness of public procurement system	19(i)	B or above	The legal framework meets **one or none** of the above six listed requirements.	The legal framework meets **two or three** of the above six listed requirements.	The legal framework meets **four or five** of the above six listed requirements.	The legal framework meets **all six** of the following listed requirements: (1) the organizational hierarchy and procedures of public procurement are clear; (2) access to procurement information by the public is secured; (3) public procurement rules are applied to all government entities; (4) competitive public procurement is the

							first principle and exceptional ways with reasons are the second principle; (5) all of the required items of procurement information (government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints) are provided for the public; and (6) an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature is secured.
14. Internal Controls and Internal Audits (Note: Use with IIA Capacity Matrix)	Types of internal audit; who has responsibility for accountability to whom; operation of follow-ups and actions	-	(reference) PI-21 C or above	Rules and guidelines for internal auditing for all government entities are **not established.** An internal audit committee has **not been established** in most government entities. Even where a committee has been established, compliance **audits and financial audits are operational systematically. Internal audit reports are not**	Rules and guidelines for internal auditing for all government entities are **established.** An internal audit committee is **under establishment** in each government entity. **Compliance audits, financial audits, and other types of internal audits** are operational by major central government entities, but they	Rules and guidelines for internal auditing for all government entities are **established.** An internal audit committee is **under establishment in half or more than half** of the ministries, departments, and agencies. **Compliance audits, financial audits, and other types of internal audits** are operational by the majority of central	Rules and guidelines for internal auditing for all government entities are **established.** An internal audit committee is **established** in **all** the ministries, departments, and agencies. **Compliance audits, financial audits, and other types of internal audits** are operational, practically following IIA (the Institute of

				issued, or are **issued irregularly,** and are **insufficiently deliberated** by its audit committee. **The results are not reported**, or are **reported but action is not taken on the results.**	are **not following IIA** (the Institute of Internal Auditors) standards. **Risk-based audits have been partially introduced.** Internal audit reports are **issued regularly** for most government entities, but **may not be submitted to the finance ministry and the SAI.** Based on audit results, **a fair degree of action is taken on major issues but often with delay.**	government entities, practically **following IIA** (the Institute of Internal Auditors) standards. **Risk-based audits have been partially introduced.** Internal audit reports adhere **to a fixed schedule** are **submitted to the finance ministry or the SAI periodically** and deliberated by its audit committee. Based on audit results, **action is prompt and comprehensive** across central government entities in many cases.	Internal Auditors) standards. **Risk-based audits have been introduced.** Internal audit reports adhere **to a fixed schedule** are **submitted to the finance ministry or the SAI periodically** and **deliberated by its audit committee.** Based on audit results, **action is prompt and comprehensive across central government entities.**
15. Reporting (*)	Public access to fiscal information	10	-	The government makes **available to the public none** of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.	The government makes **available to the public one or two** of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.	The government makes **available to the public three or four** of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.	The government makes **available to the public five or six** of the six listed types of information: (1) annual budget documentation, (2) in-year budget execution reports, (3) year-end financial statements, (4) external audit reports, (5) contract awards, and (6) resources available to primary service units.
	Quality and timeliness of in-year financial statements	24	C or above	Comparison to the budget may **not be possible across all main administrative headings.** Quarterly reports are either	Comparison to budget is **possible only for main administrative headings.** Expenditure is captured	Classification allows comparison to budget but **only with some aggregation.** Expenditure is **covered at both**	Classification of data allows **direct comparison** to the original budget. Information includes **all items** of budget

				not prepared or often **issued with more than eight weeks' delay.** Data is **too inaccurate to be of any real use.**	**either at commitment or at payment stage** (**not both**). Reports are prepared quarterly (possibly excluding first quarter), and **issued within eight weeks** of end of quarter. There are **some concerns about the accuracy** of information, which may not always be highlighted in the reports, but this **does not fundamentally undermine their basic usefulness.**	**commitment and payment stages.** Reports are prepared quarterly, and **issued within six weeks** of end of quarter. There are **some concerns about accuracy**, but data issues are generally highlighted in the reports and **do not compromise overall consistency/usefulness.**	estimates. Expenditure is **covered at both commitment and payment stages.** Reports are prepared quarterly or more frequently, and **issued within four weeks** of end of period. There are **no material concerns regarding data accuracy.**
	Quality and timeliness of final statements	25	C or above	A consolidated government statement is **not prepared annually**, OR **essential information is missing** from the financial statements OR the financial records are **too poor to enable auditing.** If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year. Statements are **not presented in a consistent format** over time, OR accounting standards are not disclosed.	A consolidated government statement is **prepared annually. Information on revenue, expenditure, and bank account balances may not always be complete**, but the omissions are not significant. The statements are submitted for external audit **within 15 months** of the end of the fiscal year. Statements are **presented in a consistent format** over time **with some disclosure of accounting standards.**	A consolidated government statement is **prepared annually.** It includes, **with few exceptions, full information** on revenue, expenditure, and financial assets/liabilities. The consolidated government statement is submitted for external audit **within 10 months** of the end of the fiscal year. **IPSAS or corresponding national standards are applied.**	A consolidated government statement is **prepared annually** and includes **full information** on revenue, expenditure and financial assets/liabilities. The statement is submitted for external audit **within six months** of the end of the fiscal year. **IPSAS or corresponding national standards are applied** for all statements.
16. Financial	Operation and	-	-	**A basic** accounting system	**All or partial IFMIS functions**	**All or partial IFMIS functions**	**All or partial IFMIS functions**

Management Information System (FMIS)	application of accounting system			has been introduced and is **operational to some extent. Prerequisites for introducing an IFMIS** (e.g., accounting items, accounting procedures and practices, human resources for IT department, financial resources for O&M, etc.) **are not well satisfied.**	**have been introduced in some departments** of major entities of central government (big spenders). **Allocation of human resources to an IT department and financial resources for O&M are progressing.**	**have been introduced** in major entities of central government (big spenders) and **most of them are operational.** Human resources are **partially allocated** to an IT department and financial resources for O&M are secured to some extent.	**have been introduced** in all entities of central government and **most of them are operational.** Human resources are **well allocated** to an IT department and financial resources for O&M are almost secured.
17. External Audits and Parliamentary Scrutiny (*)	Scope and nature of audits performed	26	C or above	Audits cover central government entities representing **less than 50% of total expenditures** or audits have higher coverage but **do not highlight the significant issues.**	Central government entities representing **at least 50% of total expenditures** are audited **annually. Audits predominantly comprise transaction-level testing,** but **reports identify significant issues. Audit standards may be disclosed to a limited extent only.**	Central government entities representing **at least 75% of total expenditures** are audited **annually,** at least covering revenue and expenditure. **A wide range of financial audits are performed and generally adhere to auditing standards, focusing on significant and systemic issues.**	**All entities of central government are audited annually covering revenue, expenditure, and assets/liabilities.** A full range of financial audits and **some aspects of performance audits are performed** and generally **adhere to auditing standards, focusing on significant and systemic issues.**
	Timeliness of submission of audit reports to legislature and evidence of follow-up on audit recommendations	28	C or above	Audit reports are submitted to the legislature **more than 12 months** from the end of the period covered (for audits of financial statements, from their receipt by the auditors). There is **little evidence of response or follow-up.**	Audit reports are submitted to the legislature **within 12 months** of the end of the period covered (for audits of financial statements, from their receipt by the auditors). **A formal response is made,** though **delayed or not very thorough,** but there is **little**	Audit reports are submitted to the legislature **within eight months** of the end of the period covered and in the case of financial statements, from their receipt by the audit office. **A formal response is made in a timely manner,** but there is **little evidence of systematic**	Audit reports are submitted to the legislature **within four months** of the end of the period covered and in the case of financial statements, from their receipt by the audit office. There is **clear evidence of effective and timely**

					evidence of any follow-up.	follow-up.	follow-up.

Notes:
1. (*) are equivalent to PEFA performance indicators.
2. On utilizing PEFA indicators, M1 and M2 are not separated strictly.
   On utilizing PEFA indicators, Level 1, Level 2, Level 3, and Level 4 respectively correspond to D, C, B, and A in the PEFA rating.

Capacity diagnostic matrices of Tax Administration, Customs Administration, Internal Audits, and External Audits

These four capacity diagnostic matrices are prepared as supplementary volumes. The capacity diagnostic matrix for Internal Audits uses the matrix prepared by the Institute of Internal Auditors (IIA) as a capacity matrix as well.

In order to measure performance of an external auditor (SAI), refer to the framework below.

SAI Performance Measurement Framework

http://www.idi.no/artikkel.aspx?MId1=102&AId=704

Appendix 2: List of Key Questions

01. Legislative and Institutional Budgetary Frameworks

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Basic information on the laws and regulations governing public finance and budgeting] n What are the major laws and/or regulations on PFM? Does the constitution make any provision for PFM? n Is provision made for fiscal discipline (in respect of budget deficits, the public debt to GDP ratio, etc.), comprehensiveness, transparency, accountability, the budget preparation process and its timing, budget preparation methods, the roles of the relevant authorities, and parliamentary involvement? (Literature-based check.) n Is a specific agency mandated to lead the budget preparation work? Is it the finance ministry or an organization akin the Office of Management and Budget (OMB) in the US? n Is separate provision made for authority and responsibility in	[Basic information on the laws and regulations governing public finance and budgeting] n Is separate provision made for the role of parliament in the budget preparation process or is this covered by finance legislation? (Check the literature following the interview.) n Are punitive measures in place for deficit spending? Which laws and/or regulations provide for this?	[General information on the laws and regulations governing public finance and budgeting] n Do the regulations on the role of parliament limit parliamentary authority over revisions to budget proposals submitted by the executive branch? Under what law/regulation is this regulated and how? (Are there legal limitations on the size of cuts that can be made, for example, or prohibitions on increases to budget proposals?) n Is there legal provision limiting the period of time that parliament may delay its budget resolution and on measures to deal with such tactics? What form do these provisions take? (For example, is provision made for the formation of a provisional budget that will allow government agencies to continue operating in the event that parliament fails to pass the budget by the beginning of the financial year?)

	sub-national levels of government in the relevant legislature? Or are the finances of national and sub-national levels of government covered by a single law? (Note: Finance legislation generally establishes policy on inter-governmental fiscal relations.) [Applicable PEFA indicators] PI-11	[Applicable PEFA indicators] None	[Applicable PEFA indicators] None
Advanced issues	[Framework of compliance with the laws and regulations governing public finance and budgeting] n Is there a legal compliance framework? (In respect of budgetary commitments with punitive measures in place for the breaching of budget targets, etc.) [Applicable PEFA indicators] PI-11		

02. Budget Credibility and Execution

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	n In one out of the last three years has there been some deviation from budgeted expenditure with regard to any of issues below? ① Total expenditure		

	② Composition of expenditure ③ Total revenue n What percentage of total expenditure is taken up by the stock of arrears? Are reliable and complete data generated on the stock of arrears? With what frequency? Is this on an ad hoc basis or routine work? [Applicable PEFA indicators] PI-1 to 4		
Advanced issues			

03. Budget Comprehensiveness

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Comprehensive coverage] n What percentage of public finance operations is included in the general account? Is it ① less than 60%, ② 60-70%, ③ 70-80%, ④ 80-90%, or ⑤ 90% or more? (Use analysis produced by private-sector think tanks.) n Where the above does not apply, identify through questions which organizations and/or funds are not included in the general account, and accumulate data on the relevant organizations and/or	[Comprehensive coverage] n Is the relationship of the scope of fiscal data between "general government" as defined by SNA and the country in question ① virtually identical, ② close, or ③ substantially different? n Are fiscal transfers (including general and special grants) to sub-national levels of government, the national and state-run corporations (including Kosha or Kodan, i.e., public corporations), and government-backed contingent	

	funds. [Note: Numerical forecasts of market tendencies are to be added at a later date.] [Applicable PEFA indicators] PI-6 PI-7	liabilities included in the general account? [Applicable PEFA indicators] PI-6	
	[Investment budgets and recurrent budgets] n Are the investment budgets and the recurrent budgets listed as a single item in the general account or as separate items? n Where the investment budget and recurrent budget are listed separately, are different ministries responsible for the two budgets? If so, which ministries have responsibility? n Are reforms in progress aimed at integrating the investment budget and the recurrent budget? n What relationship is there between new investment and the recording of current expenditure in consideration of the new investment? Is the government required to provide estimates of current expenditure? Do these include maintenance and operation costs? Is personnel expenditure linked to the investment budget?	[Investment budgets and recurrent budgets] n Where separate: Are separate parliamentary resolutions required for the investment and recurrent budgets? n Where separate: What provision is made for decisions regarding investment budget execution, accounting rules, reporting, audits, information disclosure, and so forth? Is this taken care of through parliamentary monitoring? n Do investment budget forecasts estimate total project costs, as opposed to estimation on a single-year basis?	[Investment budgets and recurrent budgets] n Are the investment budgets and recurrent budgets integrated for the purpose of compiling forward estimates, or is only one of the two budgets factored in?

	[Applicable PEFA indicators] PI-5	[Applicable PEFA indicators] PI-5	[Applicable PEFA indicators] None
	[Extra-budgetary funds] n How many extra-budgetary funds are provided for under the law? n How many extra-budgetary funds are not provided for under the law? Are these funds included in the general account? n Is an extra-budgetary fund subject to a resolution of parliament? n What provision is made for decisions regarding the execution of extra-budgetary funds, accounting rules, reporting, audits, information disclosure, and so forth? Is this taken care of through parliamentary monitoring? [Applicable PEFA indicators] PI-7	[Extra-budgetary funds] n Do the extra-budgetary funds include funds to finance statutory funds (funds that the government is required by law to provide), the use of which is predetermined, and special funds, the use of which is at the discretion of the competent ministry or agency? n What legal provision is made for the setting up of special funds? n Does the budget include both items that are subject to annual voting and permanent appropriations (pensions, etc.), which can be executed without a parliamentary vote? [Applicable PEFA indicators] PI-7	[Extra-budgetary funds] n Is the finance ministry the legally mandated administrator of statutory funds? Are statutory funds listed in the budget? If not, is there a legal requirement to report transfers of statutory funds from the general account to the government (finance minister) and parliament? n Are special funds listed in the budget? If not, is explicit provision made for the transfer and/or carrying forward of special funds from the budget by government ministries? What reporting obligations are in place? [Applicable PEFA indicators] PI-7
	[National and state-run corporations] n Are independent public entities such as national and state-run corporations (Kosha or Kodan, i.e., public corporations included) included in the general account? n Where investment by independent public entities such as national and state-run corporations (Kosha or		

	Kodan, i.e., public corporations included) comes out of the general account, is it included in the investment budget? [Applicable PEFA indicators] PI-7 PI-9		
Advanced issues		[Extra-budgetary funds] n When the general account is submitted to parliament, is a revenue/expenditure plan (including both fund flows and revenue/expenditure plans) for extra budgetary funds submitted simultaneously? [Applicable PEFA indicators] PI-7	

04. Budget Classification

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Budget classification] n What are the existing budget classifications (e.g., functional, economic, and administrative)? n Do all public entities use the same budget classifications?	[Budget classification] n To what purpose are the three budget classifications listed to the left utilized? If, for example, there is a ceiling, which categories are linked? n Do the functional categories correspond to the COFOG (UN	[Budget classification] n How is revenue classified?

	[Applicable PEFA indicators] PI-5	Classification of the Functions of Government) of GFS (Government Finance Statistics)? [Applicable PEFA indicators] PI-5	[Applicable PEFA indicators] PI-5
Advanced issues	[Budget classification] n Do the budget classifications correspond to the chart of accounts? n Are any other budget classifications used besides the ① functional, ② economic, and ③ administrative categories? For example: ④ fund classification and/or ⑤ program classification. [Applicable PEFA indicators] PI-5	[Budget classification] n To what purpose are the five budget classifications listed to the left utilized? n What attempts are made to gear policy issues to functional classifications? Are correspondence tables created, for example? [Applicable PEFA indicators] PI-5	

05. Budget Preparation and Budget Allocation

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Budget preparation methods] n What method of budget preparation is used? Is it line item budgeting, program budgeting, or	[Budget preparation methods] n During the budget preparation process, are macro-economic forecasts and fiscal target estimates	[Budget preparation methods] n What do supplemental budget decisions involve? What level of government has approval authority?

	performance budgeting? n If a program or performance budgeting system is used, what type of budgeting system is involved? [Applicable PEFA indicators] PI-11	approved in parliament before a budget circular (or budget call) can be issued? n Does the finance ministry set benchmark costs and cost calculation methods and are the various ministries required to adhere to the same? n Over the past three years, how many supplemental budgets have been implemented on average each year? [Applicable PEFA indicators] PI-11	How are supplemental budget policies formulated and made available to the general public? [Applicable PEFA indicators] PI-11
	[Budget preparation schedule] n What are the deadlines for the various stages in the budget preparation process and for each of the tasks involved? Are these deadlines statutory and/or institutionalized? n In what month are the ministries charged with budget implementation actually notified of the amounts available to them?	[Priority areas in the budget preparation process] n Are policy priorities subject to parliamentary debate in the early stages of the budget preparation process? Do these debates have any real influence on the budget preparation process? n What degree of influence do ministerial strategies have on budget allocation? Or do ministerial strategies have no material impact on actual allocations? n Has the head of government (the prime minister or president) ever overturned a budget decision made by the finance minister during the budget preparation process? n Are investment budget review	

	[Applicable PEFA indicators] PI-11	standards and procedures clearly documented? [Applicable PEFA indicators] PI-11 PI-12	
	[Budget ceilings] n Is a document issued stating the budget ceiling to government ministries? When is this document issued? (Note: This normally comes in the form of a budget circular or budget call, for example.) n What level of government is responsible for giving the budget circular/call the final go-ahead prior to its official release (e.g., the finance minister, cabinet, or parliament)? [Applicable PEFA indicators] PI-11 PI-12	[Budget ceilings] n What information is contained in the budget circular/call? (Does it specify a budget preparation process schedule and/or budget ceilings, for example?) n What was the percentage difference between initial budget ceilings and actual budget appropriations in the current fiscal year? If budget appropriations were higher than the ceiling, were the final approval decisions made by the finance minister? [Applicable PEFA indicators] PI-11 PI-12	[Budget ceilings] n Of the budget ceilings applied, which ceiling takes precedence? Is it (1) program ceilings, (2) portfolio ceilings, (3) ceilings on current policies, (4) ceilings on new policies, (5) ceilings on forward estimates, or (6) equal precedence on all five? n Are budget ceilings set uniformly on the basis of a year-to-year comparison, uniformly minus any permanent appropriations, or using another method? (If an alternative method is used, do ceilings apply to both or just one of the investment and/or the recurrent budget? When compared, do budget allocations for different ministries and programs increase/decrease by the same percentage?) [Applicable PEFA indicators] PI-11 PI-12
	[Expenditure analysis]	[Expenditure analysis]	[Expenditure analysis]

	- By what percentage did total expenditure vary from the budget appropriations? - By what percentage did total revenue vary from the budget appropriations? - Which are the major ministries charged with budget implementation (the so-called “big spenders”)? Is there evidence of any trends over the past three to five years? What are the prospects for the future? - Are there any fixed items of expenditure (e.g., education spending of a certain percentage of government expenditure)? If so, is this enshrined in a specific law and/or regulation? [Applicable PEFA indicators] PI-1 PI-3	- Fluctuation/movement between major budget items: What degree of fluctuation/movement was there between major budget items? (By functional or program classification where the budget classifications correspond to the categories presented in the budget execution report, or by administrative classification otherwise.) - What percentage of total expenditure is accounted for by liabilities accrued since the beginning of the financial year? [Applicable PEFA indicators] PI-2 PI-4	- Is there evidence of any trends in investment expenditure over the past three to five years? What are the prospects for the future? How does the government plan to fill the gap between revenues and expenditure (by, for example, issuing government bonds or through official donations, etc.)? - Is there evidence of any trends in major projects in the sector in question over the past three to five years? What are the prospects for the future? Have budget allocations and actual appropriations/budgets been sufficient to cover operating and maintenance costs? [Applicable PEFA indicators] None
Advanced issues		[Correspondence between forward estimates and annual budgets] - Where the expenditure structure in forward estimates has diverged from that in the annual budget, has the government issued a public statement to explain why this has occurred? [Applicable PEFA indicators]	

		PI-12	

06. Medium-Term Perspectives in Budgeting

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Medium-term macro-economic forecasting and fiscal targets] n Is medium-term macro-economic forecasting made in some form? How accurate is it? Are the forecasts made public? n Which department is charged with formulating medium-term macro-economic forecasting? n Does the government set medium-term fiscal targets? If so, what targets does it set? (For example, budget deficits and/or the public debt to GDP ratio.) [Applicable PEFA indicators] PI-12	[Medium-term macro-economic forecasting and fiscal targets] n Is medium-term macro-economic forecasting subject to parliamentary approval? n At what stage of the beginning of the budget preparation process is medium-term macro-economic forecasting required to be submitted to parliament? Medium-term macro-economic forecasting continues during the budget preparation process as well as at the beginning of the process, but at what stage in this process is the latest macro-economic forecasting factored into the budget draft? n Are the postulates used in setting medium-term fiscal targets made public? Are they subject to parliamentary approval? Do the fiscal targets function? [Applicable PEFA indicators] PI-12	[Medium-term macro-economic forecasting and fiscal targets] n Are the MTEF and/or MTBF[10] subject to parliamentary approval? n Which departments are responsible for the respective balance of payments, real economy, and central government banking sector forecasting? [Applicable PEFA indicators] PI-12
Advanced	[MTEF preparation]	[MTEF preparation]	[MTEF preparation]

[10] MTEF = medium-term expenditure framework, MTBF = medium-term budget framework.

issues	n Does the government formulate an MTEF? What was the background to and purpose of introducing the MTEF? n How accurate is it? n Is the MTEF referenced and utilized by the departments responsible for development and/or sector planning and investment planning? n Is resource allocation consistent with MTEF priorities? [Applicable PEFA indicators] PI-12	n Does the government create forward estimates?[11] What specific expenditure items are included in the forward estimates in the country in question?	n Is the MTEF compiled on the basis of forward estimates? n What expenditure items need to be included in the estimates that are submitted with new policy proposals? Examples include: ž Costs for the current fiscal year ž Costs over the medium-term ž Costs of quasi-fiscal activities ž Tax expenditure ž Costs of counteracting fiscal risk ž Total costs over a span of several financial years [Applicable PEFA indicators] PI-12

07. Performance Evaluation in the Budgeting Process

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Performance evaluation in budget preparation] n What was the background to and purpose of introducing program and/or performance budgeting? (In terms of purpose, was this type of budgeting adopted to facilitate the		[Performance evaluation in budget preparation] n Where the finance ministry and the ministries responsible for budget planning are different, how do their assigned roles differ? n Where the ministries charged with

[11] Forward estimates are a rolling plan for budget expenditure. They are generally premised on the assumption of the continuation of existing policy (i.e., of no change to current policy) and project the level and composition of government expenditure on the basis of economic forecasts, etc., over the medium term (three years). Although these budget projections are referred to as forward estimates, in practice they tend to be put to different uses around the world.

	strategic allocation or resources or the maintenance of fiscal discipline, etc.?) n What type of program and/or performance budget is used? n What type of review mechanism is employed by the finance ministry? Is it (1) expenditure review, (2) sector review, (3) new project review, (4) ex-post evaluation, or (5) continuous program review? Are such reviews undertaken periodically or on an ad-hoc basis? n How does the finance ministry use the results of its performance evaluations? (Are they, for example, merely referenced when looking into budget allocations or do they form part of the budget negotiations on reallocation, etc.?) n What level of information is used in the budget preparation work (e.g., information on specific programs or projects, etc.)? n Does the finance ministry have sequences/scenarios for linking performance evaluation data to future budget allocations? [Applicable PEFA indicators] None		budget implementation have failed to reflect performance evaluation findings in their annual budget requests, what measures were taken in response? For example, (1) was ministerial involvement in the relevant program increased, (2) was the oversight made public, (3) was it reflected in the budget allocations for the year, or (4) was a warning issued? [Applicable PEFA indicators] None
Advanced issues	[Performance evaluation mechanisms] n What is the mechanism for	[Performance evaluation mechanisms] n Are performance evaluation findings	[Performance evaluation mechanisms] n Is there a monitoring and/or follow-up

	performance evaluations? Does it involve result chains? How many performance indicators are used? [Applicable PEFA indicators] None	released to the general public? n What level of interest do performance evaluation findings generate in parliament, CSO, and the media? [Applicable PEFA indicators] None	process for performance evaluation findings? n Where key performance indicators are not attained for a program/project, are there punitive measures prescribed under specific laws and/or regulations? n Are all officials with authority to spend public funds subject to performance evaluation? Is adherence to policy on effective and efficient use of funds and management control mandatory? Which laws provide for this? [Applicable PEFA indicators] None

08. Cash Management and Planning, and Disbursement

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Cash flow management] n Which finance ministry department is responsible for drafting cash plans? n How often is the bank reconciliation process conducted? n Are there rules and/or prescribed procedures for commitment management? How accurate are they?	[Cash flow management] n How and with what frequency are cash flow management, cash flow forecasting, and cash flow planning conducted? n Where other accounts have been opened in addition to the treasury account, at what intervals are these accounts reconciled against the general ledger?	[Cash flow management] n Are the ministries charged with budget implementation required to compile monthly cash flow estimates and submit them to the finance ministry for approval? n Are the ministries charged with budget implementation required to submit reports comparing monthly cash flow estimates with actual allocations and cash flows to the finance ministry on a regular basis? n Are fiscal plans adjusted to reflect

	[Applicable PEFA indicators] PI-17 PI-22	[Applicable PEFA indicators] PI-17 PI-22	revenue forecasts? If so, is this information made available to all government ministries? n Are cash flow plans subject to weekly review on the basis of revenue monitoring? Or is their consistency with fiscal plans subject to review? n Where other accounts have been opened in addition to the treasury account, are these accounts reconciled with the general ledger or have computer systems been introduced to allow for cash holdings to be reflected into the general ledger in real time? [Applicable PEFA indicators] PI-16 PI-17
	[Budget allocation] n Is the budget allocation procedure clearly documented? How does it work in practice? n Are budget allocations made on a monthly or a quarterly basis? Does this vary from ministry to ministry? n Viewed on a quarterly basis, what percentage of the scheduled allocations is actually allocated each quarter? (Look at data for the past three years.) What percentage of the scheduled allocations is ultimately allocated?	[Budget allocation] n Where revenues are less than planned, has explicit regulatory provision been made for the distribution of budget allocations? Are budget ceilings cut by the same percentage across the board, by a uniform percentage minus permanent appropriations, or according to an alternative method? n Are such decisions made by the competent ministry or are they subject to finance ministry and/or cabinet approval? Is the matter	[Budget allocation] n Since the various ministries commit funds on the allocations given in the fiscal plan, which reflects official budget appropriations, have there been instances in which ministries have been unable to make good on their commitments due to lower than expected budget allocations? (Check to confirm whether the monthly cash flow forecasts compiled by individual ministries are shared with the finance ministry.) n Are such outstanding expenses

	(Look at data for the past three years and include supplemental budgets where appropriate.) [Applicable PEFA indicators] PI-17	reported to parliament? n What percentage of the total budget allocation is allocated automatically, i.e., without a demand from the ministry concerned? (Where possible, ascertain the percentage of the total for each ministry.) [Applicable PEFA indicators] PI-17	written off at the end of the financial year or paid for using the first budget allocation in the new financial year? n Is personnel expenditure included in the fiscal plan or is it deemed to be a permanent appropriation? Where it is included in the fiscal plan, is it integrated into post and payroll management and thus subject to annual review? [Applicable PEFA indicators] PI-17 PI-18
Advanced issues	[Multi-year cash flow management] n Where a specific program spans a certain period (number of years), does cash flow management allow for commitments to be made over a predefined number of years? n In nations that work on the principle of single-year budgets but allow for unspent allocations to be rolled over into subsequent years, is explicit provision made for the maximum percentage that may be brought forward at the end of the financial year? n In nations that permit unspent budget to be rolled over, is this limited to projects on which the finance ministry has received adequate explanation on the		

	reasons for the rollover? [Applicable PEFA indicators] PI-17		

(Complementary) Treasury Single Account

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Introduction and management of a Treasury Single Account] n Has the country introduced a Treasury Single Account? When did it do so? (Literature-based check.) n Which organizations are currently included in the Treasury Single Account framework? a) Government ministries and agencies b) Sub-national levels of government c) Extra-budgetary funds d) Independent government agencies e) Other public entities (national/state-run corporations) n Of the accounts listed above, are there plans to incorporate those not currently included in the Treasury Single Account into that account at a later date? If so, when?	[Introduction and management of a Treasury Single Account] (The following deal with the introduction of an IFMIS and checks on its continuity and responsiveness.) n Is the Treasury Single Account listed as a budget classification in the general ledger or as a chart of accounts? n Do the organizations included in the Treasury Single Account simply draw down funds or are they also permitted to open commercial bank accounts and remit funds? From the categories listed to the left, which are permitted to open commercial bank accounts? n Are the organizations that have commercial bank accounts linked to an IFMIS? n How does the treasury keep track of receipts and disbursements from such commercial bank accounts? n How often are Treasury Single Account receipts and	[Introduction and management of a Treasury Single Account] n An interbank data network and a clearing system for interbank payments are necessary for the operation of a Treasury Single Account. Are improvements being made to this infrastructure in conjunction with the establishment of the Treasury Single Account?

	[Applicable PEFA indicators] PI-17	disbursements reported to the finance ministry and/or parliament? [Applicable PEFA indicators] PI-17	[Applicable PEFA indicators] PI-17
Advanced issues	[Introduction and management of a Treasury Single Account] n Are all public entities incorporated in the Treasury Single Account framework? [Applicable PEFA indicators] PI-17		

09. Debt Management

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[The institutional framework for debt management and its operation] n Has the government established basic principles and policies on debt management and made them available to the general public? n Is discipline enforced in respect of debt management (on the public debt to GDP ratio, for example)? n Has the government installed a dedicated debt management department? Is the operation under a jurisdiction stipulated by law? Is the public aware of finance	[The institutional framework for debt management and its operation] n Does the law on debt discharge make explicit provision for debt reduction and exemption standards? n Does the aforementioned law on debt discharge limit borrowing by sub-national levels of government to the central government, or are sub-national levels of government permitted to borrow from any source and/or issue bonds insofar as they obtain permission from the finance ministry in advance?	[The institutional framework for debt management and its operation and relation to monetary policy] n Is information on the amount of public debt, the public debt portfolio and its currencies, due dates and interest, and other matters disclosed to the general public on a regular basis? n What relationship is there between policy on debt management and monetary and fiscal policy? What provision is made for the exchange of policy-related information?

	ministry and central bank jurisdiction over the debt management process? n Is the locus of authority for approving new debt and the procedure for voting on the performance of government obligations clearly enshrined in the law? n Is debt management monitored through external audits? How often are these audits conducted? n Is central government debt the sole object of debt management or are the debts of sub-national levels of government also covered? [Applicable PEFA indicators] PI-17	[Applicable PEFA indicators] PI-17	n What consideration is made for maintaining separation between debt management policy and monetary policy? n Does the law on debt discharge mandate the inclusion of asset-liability transactions involving public funds in the budget or are such transactions submitted to parliament with the budget as a separate document? n Does the law on debt discharge provide for authorization and responsibility for government finance, the provision of state guarantees, and relevant reporting? [Applicable PEFA indicators] PI-17
Advanced issues	[The institutional framework for debt management and its operation] n Is short-term borrowing from the central bank permitted? Is there an upper limit on such borrowing? n Does the government issue state bonds for both domestic and foreign investors? n Has a fiscal risk matrix been created?	[The institutional framework for debt management and its operation] n What steps are taken to mitigate the various risks associated with decisions on government borrowing and/or guarantees? (Are, for example, stress tests performed on the debt portfolio? Specific risks include cash flow risk, portfolio structure risk, exchange rate risk, and the risks posed by natural disasters, etc.) n How often are stress tests performed on the debt portfolio?	[The institutional framework for debt management and its operation] n What steps does the department responsible for public debt management take to control foreign currency borrowings and the debt generated by domestic short-term variable interest rates? n Which organization is responsible for monitoring the primary market? n Are steps being taken to maximize the use of market mechanisms in the primary market, including competitive auctions and/or

	[Applicable PEFA indicators] PI-17	[Applicable PEFA indicators] PI-17	syndication in respect of government bond issues? [Applicable PEFA indicators] PI-17

10. Asset Management

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	n Does the country have laws and/or regulations on asset management? n Is explicit provision made on the locus of responsibility for asset management and record keeping? n Are records kept of all fixtures and government-owned financial assets? [Applicable PEFA indicators] None		
Advanced issues	n Are records kept of all fixtures and government-owned financial assets, and are they tracked until such assets are disposed of? How often are these records updated? [Applicable PEFA indicators] None		

11. Revenue Administration

Note: Research on tax administration is to be conducted on the basis of the *Diagnosis Matrix for Tax Administration Capacity* edited by the National Tax Agency.

12. Accounting Procedures

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Budget execution procedures] n Is there a chart of accounts? Is it consistent with the IMF's GFS?[12] n Are budget execution procedures clearly documented? Is decision-making authority clearly defined? n How are unspent budget items dealt with? [Applicable PEFA indicators] PI-20	[Budget execution procedures] n Are the ministers in charge of the ministries charged with budget implementation capable of reallocating and executing funds within their respective budget ceilings? Are such reallocations made between major policies or between expense items listed in the budget appropriation? What percentage (or upper limit) of the budget can be reallocated? What expense items are eligible for reallocation? n Are central government ministries and agencies, sub-national levels of government, and other public entities authorized to make commitments only on the basis of a spending plan that has been compiled within the scope of their budget appropriation, or are they permitted to commit on the basis of their actual allocation? [Applicable PEFA indicators] PI-20	[Budget execution procedures] n Is the diversion of personnel expenses to other expense items, and vice versa, prohibited? [Applicable PEFA indicators] PI-20

[12] GFS = Government financial statistics.

	[Public sector accounting rules] n Does the government employ some form of public sector accounting rules (for example, cash basis, modified cash basis, modified accrual basis, or accrual basis accounting)? [Applicable PEFA indicators] PI-25		
Advanced issues	[Budget execution procedures] n Do the ministries charged with budget implementation use accounting rules and internal controls in compliance with finance ministry standards? [Applicable PEFA indicators] PI-20	[Budget execution procedures] n Do the ministries charged with budget implementation keep records of their commitments and cash transactions when using budget funds? [Applicable PEFA indicators] PI-20	
	[Accounting rules] n Has the country introduced the International Public Sector Accounting Standards (IPSAS) established by the International Federation of Accountants (IFAC)? [Applicable PEFA indicators] PI-25		

13. Public Procurement

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Institutional frameworks and defined procedures] n What are the laws governing public procurement? n Which government office is responsible for setting public procurement policy and procedure? [Applicable PEFA indicators] PI-19	[Institutional frameworks and defined procedures] n Do public procurement procedures establish separate procedures for the procurement of goods, construction services and other services? [Applicable PEFA indicators] PI-19	[Institutional frameworks and defined procedures] n Do public procurement procedures provide standard operating procedures for lump sum bid payments, bid opening, appraisal, disclosure, record keeping, and filing? Are these procedures disclosed to the general public? [Applicable PEFA indicators] PI-19
Advanced issues	[Institutional frameworks and their oversight organizations] n Is public procurement undertaken by the national public procurement agency or by respective ministries, sub-national levels of government, and other public entities? If the latter, has an oversight organization been established to monitor public procurement activity as a whole? n Is this oversight organization clearly defined? n What is the situation of the disclosure of information relating to public procurement?	[Institutional frameworks and their oversight organizations] n Where an oversight organization has been established to monitor public procurement as a whole and the public procurement of sub-national levels of government is also monitored, how many regional offices have been established and how many staff do they employ? n When the public procurement agency or oversight organization issues standard operating procedures for public procurement, are the results monitored? n Does the public procurement agency or oversight organization	[Defined procedures] n Are there transparent and widely-known procedures on the disclosure of winning bid decisions and the making of appeals and challenges in respect of such decisions? n Are parties other than the bid participants eligible to make appeals and challenges?

	[Applicable PEFA indicators] PI-19	have the authority to collect, analyze, and compile reports on statistical data on procurement from all organizations covered by the public procurement law? [Applicable PEFA indicators] PI-19	[Applicable PEFA indicators] PI-19
	[Training] n Has the public procurement agency or oversight organization developed training programs for procurement officers? Does it provide the relevant training? [Applicable PEFA indicators] PI-19	[Training] n Are procurement specialists employed and have the relevant training programs been developed for such personnel? n Have special programs been developed to keep potential private sector bidders informed and offer them the relevant training? [Applicable PEFA indicators] PI-19	
	[Institutional frameworks and their oversight organizations] n Does a centralized public procurement organization or national oversight organization keep track of information on most public procurement, and is this firmly controlled? n Have adequate numbers of personnel received the proper		

	training? [Applicable PEFA indicators] PI-19		

14. Internal Controls and Internal Audits

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Institutional frameworks for internal controls and audits] n What structures does the central government have in place for implementing internal controls and internal audits? n What internal audits does it implement? Are they (1) compliance audits, (2) financial audits, (3) system audits, and/or (4) procurement process audits? Are these audits risk-based? n Is it clear who has accountability to whom in respect of internal audit findings? (That is, who do the internal auditors report to?) What follow-up mechanisms are in place to track audit committee recommendations?	[Institutional frameworks for internal controls and audits] n Are there strategies, guidelines, and/or manuals dealing with internal controls and internal audits? n Are all expenditure organizations required to set up an internal audit section if they are not part of a ministry or agency? n Are all expenditure organizations required to establish an internal audit committee? n Are there clearly defined guidelines on the reporting of internal audit findings? n Is there a code of conduct/ethics specific to internal auditors? What mechanisms are in place for the hiring and training of internal auditors? Are these mechanisms currently fully functional? n Are the standard internal audit procedures consistent with those of the Institute of Internal Auditors (IAA) Japan?	[Internal control and internal audit practices] n Do the departments responsible for internal controls within the finance ministry and other government ministries and agencies conform to internal control standards, and do they provide technical guidance and conduct monitoring? n Are the internal controls relating to accounting and reporting consistent with the accounting and reporting systems used by public entities in the country in question?

	[Applicable PEFA indicators] PI-21	n Are there internal control mechanisms in place? [Applicable PEFA indicators] PI-21	[Applicable PEFA indicators] PI-21
Advanced issues	[Institutional frameworks for internal audits] n Is the independence of the internal audit services department assured? n Are internal auditors dispatched by the finance ministry or independently employed by the various public entities? [Applicable PEFA indicators] PI-21	[Institutional frameworks for internal audits] n Are the duties and responsibilities of the employees responsible for internal controls within the country's public entities enshrined in laws and/or detailed regulations? n Internal audit reports are basically compiled for the management of the organization in question, but are they passed directly to an external auditor? [Applicable PEFA indicators] PI-21	[Internal audit practices] n Do the internal audits of departments charged with expenditure include internal control reviews and, where necessary, recommendations on improvements to executives throughout the organization? n Are internal audit policies and standards formulated by the finance ministry or another ministry, and are they subject to monitoring? n Are the central government organs (the finance ministry, etc.) responsible for supporting the internal audit process working to improve the knowledge and skills of, and monitoring, governmental internal audit personnel? n Is there liaison on internal audit plans with external auditors? [Applicable PEFA indicators] PI-21
	[Types of audit] n Are performance (value-for-money) audits		

	conducted? [Applicable PEFA indicators] PI-21		

15. Reporting

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[Report categories and their institutional frameworks] n What type of fiscal reports are mandatory requirements under the law?[13] n When are government-wide financial reports compiled? Is it (1) on a quarterly basis, (2) biannually, (3) within six months of the end of the financial year, (4) within six to twelve months of the end of the financial year, (5) every one to three years, or (6) at intervals of three years or more? What is the reality? n Who receives the in-year budget reports (on in-year and year-end budget progress and debt levels) compiled by the ministries charged	[Report categories and their institutional frameworks] n Are financial reports written in compliance with the public sector accounting principles employed by the country in question? n Does the finance ministry submit in-year budget reports via the cabinet to parliament at least twice a year and on an ad-hoc basis if there is a substantial change in the forecasts? n Under public finance law, are sub-national levels of government required to report monthly revenues, monthly expenditures, and their bank balances (extra-budgetary funds included) to the finance ministry or home affairs ministry?	[Report categories and their institutional frameworks] n Where in-year budget reports are compiled in the middle of the financial year, are these reports released and do they cover all expense items? n Is it possible for the treasury to obtain the in-year budget reports compiled by the ministries charged with budget implementation from the competent finance ministry department? n Are in-year budget reports other than the final accounts subject to parliamentary and cabinet scrutiny? n Where financial reports are submitted immediately after the end of the financial year, are the records

[13] Generally speaking, reports on budget execution (both quarterly and annual) include the following: in-year budget reports (which report on budget progress and government liabilities (note that the budget reports submitted by individual government ministries and agencies at the end of the financial year are normally referred to as “final account reports by government ministries and agencies”); final account statements (Final Accounts); financial reports (on the government’s fiscal position and fiscal performance: Financial Reports); and (IMF-compliant) Government Finance Statistics (GFS) reports.

	with budget implementation, and how often are such reports required (include deadlines)? Are these reports being submitted on time? n What is the official deadline for the submission of final accounts by the external auditor to parliament/the cabinet?[14] Are these reports being submitted on time? n Are the financial reports of sub-national levels of government consistent with the reports of the ministries charged with budget implementation dealt with above? [Applicable PEFA indicators] PI-23 PI-24 PI-25	[Applicable PEFA indicators] PI-23 PI-24 PI-25	of expenses accurate? n Is the gap between the initial budget and the amount executed clearly stated in the various reports that deal with budget execution? [Applicable PEFA indicators] PI-23 PI-24 PI-25
Advanced issues	[Institutional frameworks for reporting] n Do the various reports dealing with budget execution include the financial statements required for GFS in the annual financial reports?	[Report categories and their institutional frameworks] n Are documents containing information on extra-budgetary funds and contingent liabilities made available to the general public?	[Report categories and their institutional frameworks] n Are execution reports corresponding to the budget classifications reported on a daily or monthly basis? Who are these reports submitted to? n Is information disclosure mandatory

[14] In Japan, the Ministry of Finance (MoF) compiles "final accounts of the expenditures and revenues of the State" on the basis of the "final account reports of government ministries and agencies," which it submits to the Board of Audit of Japan. This statement is audited by the Board of Audit, which submits an "Audit Report" to the Cabinet. Ultimately, the "final accounts of the expenditures and revenues of the State" submitted by the MoF to the Board of Audit (i.e., the externally audited final accounts) and the "Audit Report" are submitted by the Cabinet to the National Diet.

	[Applicable PEFA indicators] PI-24	[Applicable PEFA indicators] PI-23 PI-24 PI-25	under the law? Does the government actively demand information disclosure and does it employ people to do this? Do the data available for public consumption contain information on the execution of public finances? [Applicable PEFA indicators] PI-23 PI-24 PI-25

16. Financial Management Information System (FMIS)

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[FMIS and its operational capacity] n Has the government introduced a system for accounts payable and accounts receivable, and is it being utilized? [Applicable PEFA indicators] None		
Advanced issues	[FMIS and its operational capacity] n Has the government introduced an Integrated Financial Management Information System (IFMIS)? n What data is covered by the IFMIS? Do all the government organizations that are linked to the	[FMIS and its operational capacity] n Have both single-year and multiple-year appropriations been made for IFMIS operation and maintenance? n Is there a requirement to secure personnel with the necessary skills,	

	system use the same data interface? (Do those organizations with low capacity, such as sub-national levels of government, use a simplified interface?) n What operational training is provided in respect of the IFMIS? n Have all public entities introduced the IFMIS and is it, in principle, used for the exchange of financial data? [Applicable PEFA indicators] None	i.e., accounting skills, data system operating skills, etc.? n Do IFMIS modules keep track of all public finances? (Assuming, for example, that the IFMIS covers the stages from planning through budgeting and execution, it may not cover revenues.) [Applicable PEFA indicators] None	

17. External Audits and Parliamentary Scrutiny

	Some Information Desirable	More Information Desirable	Specific Information Desirable
Basics	[External audits] n Which laws make provision for external audits? Is it (1) the constitution, (2) laws, (3) detailed regulations, or (4) other? n Is the independence of external audits guaranteed? Assuming there is institutional independence, what is the policy on the financial and other fronts (of the external audit process)? n What external audits are conducted (e.g., financial audits, compliance audits, etc.)? n Are there procedural manuals for external audits? Do these conform to international standards? n By law, how long after the end of the financial year do external audit reports need to be submitted to parliament/the cabinet? When are they actually submitted? n Do public entities respond appropriately to recommendations made in external audit reports (where, for example, the findings contradict the final account, etc.)? n When, following the end of the financial year, is the external audit report made available to the general public? (An abridged audit	[External audits] n Does the government ever set priorities for external audits? n How skilled are the auditors? n Are private sector auditors employed to conduct external audits of public entities? Where private sector auditors are involved, are such accounting firms subject to regulation? n Are attempts being made to build cooperative relations with external auditors in other countries and/or international audit organizations?	[External audits] n Is it possible to strengthen external audits, by conducting audits of internal control systems and/or audits using samples extracted from individual transactions? n How are external audits and internal audits coordinated? For example, is there coordination over audit planning? Are internal audit reports used to prevent overlap? Are there mechanisms for the exchange of ideas and know-how during the audit process? n Are there cases in which an audited organization is penalized or promoted on the strength of external audit findings?

	report tied to the final account is an acceptable form for this release.) [Applicable PEFA indicators] PI-26	[Applicable PEFA indicators] PI-26	[Applicable PEFA indicators] PI-26
	[Parliamentary scrutiny] n Are audit reports subject to parliamentary scrutiny? n Does parliament instruct the relevant ministries and agencies to respond to audit report recommendations? n Are members of parliament (the public accounts committee) capable of properly reviewing the audit reports they receive? n Are the mechanisms in place for following up on external audit recommendations? n Is there an organization charged with advising parliament on the external audit process? [Applicable PEFA indicators] PI-28		
Advanced issues	[External audits] n Are audit reports made available to the general public at the same time as they are submitted to parliament? n Are they made available in a form that the general public is able to		

	understand? [Applicable PEFA indicators] PI-28		
	[Value for Money audits] n What percentage of programs has been audited in the past five years? n Are Value for Money (VFM) audits conducted? [Applicable PEFA indicators] PI-28	[Value for Money audits] n How has the role of external audits been affected by the introduction of performance budgets? n In terms of available financial and operational resources, can external auditors be charged with a new mandate to conduct VFM audits? [Applicable PEFA indicators] PI-28	[Value for Money audits] n Is the external audit team capable of conducting VFM and IT audits? n Is there any public interest in VFM audits? [Applicable PEFA indicators] PI-28

Major Bibliographic References

- Diamond, J. 2013. Good Practice Note on Sequencing PFM Reform. Washington, DC: International Monetary Fund.
- JICA. 2013a. Thematic Guidelines on “Financial Administration and Public Financial Management. Tokyo: JICA.
- JICA. 2013b. PFM Position Paper. Tokyo: JICA.
- JICA. 2013c. An Inquiry into Good Practice in Public Financial Management by Developing Country Governments to Ensure the Sustainability of Development Outcomes. Tokyo: JICA.
- PEFA. 2011. The Public Expenditure and Financial Accountability (PEFA) Framework. Washington, DC: PEFA Secretariat.
- Shah, A., ed. 2007. *Budgeting and Budgetary Institutions*. Washington, DC: World Bank.
- World Bank. 1998. *Public Expenditure Management Handbook*. Washington, DC: World Bank.