Effective Institutions Platform

Proposals for a new PFM systems indicator for the Busan Global Partnership Monitoring Framework

Document for consultation

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1. Introduction

This note sets out a proposal for a new public financial management (PFM) indicator (9a) for the Busan Global Partnership Monitoring Framework (GPMF). The proposal is based on discussions in the Effective Institutions Platform since February 2013. The proposal will be discussed in the Effective Institutions Platform, of which CABRI is a member, on 28 and 29 October 2014. The purpose of the note is to consult with CABRI countries and EIP members on the proposals.

2. The PFM indicator

Overall indicator 9 of the GPMF measures whether country systems are being strengthened and used. The purpose of indicator 9a is to reflect the quality of developing country PFM systems as a measure of whether they are being strengthened, and to enable development partners (DPs) to make informed decisions about the level of fiduciary risk, and whether to use country systems for their financial support. The measurement of the use of country systems (in indicator 9b), is linked to the quality of PFM systems.

The current indicator is based on the World Bank Country Policy and Institutional Assessment (CPIA) methodology which rates the performance of systems (processes and inputs) across three dimensions. There are concerns that the current indicator does not sufficiently reflect or satisfy many of the principles on which the Busan agreement is predicated, namely: ownership of development priorities by developing countries, a focus on results, and transparency and mutual accountability.

A new indicator has to be transparent; provide a credible measure of country's PFM performance; provide consistency of measurement within and across countries over time; be owned by countries and be sensitive to country context; support mutual accountability; and be cost-effective, preferably using existing measure so as not to increase transaction costs.

3. Proposals for a new PFM indicator

Construction of the indicator

It is proposed that the indicator comprises two components. Component 1 will consist of a set of measures that is applied in all countries, and which reflects country performance on the core PFM systems that are deemed critical by development partners to use country systems across countries. There will be 7 measures in this component.

Component 2 allows for country specificity and comprises 7 indicators that will be selected for each country based on the specific PFM issues in that country that are being strengthened to strengthen the system overall and/or prevents development partners from using country systems in that country. The measures themselves are pre-set, to ensure consistency of measurement and credibility. Countries will select the measures and agree them with their development partners, and they may change over time.

Measurement methodology

It is proposed that indicators from the Public Expenditure and Financial Accountability (PEFA) framework are used. This means that for any one country that participates in the GPMF, the PFM indicator will comprise 7 fixed PEFA indicators, which are the same for all countries, and 7 flexible PEFA indicators that are country-issue specific. The use of PEFA is proposed because:

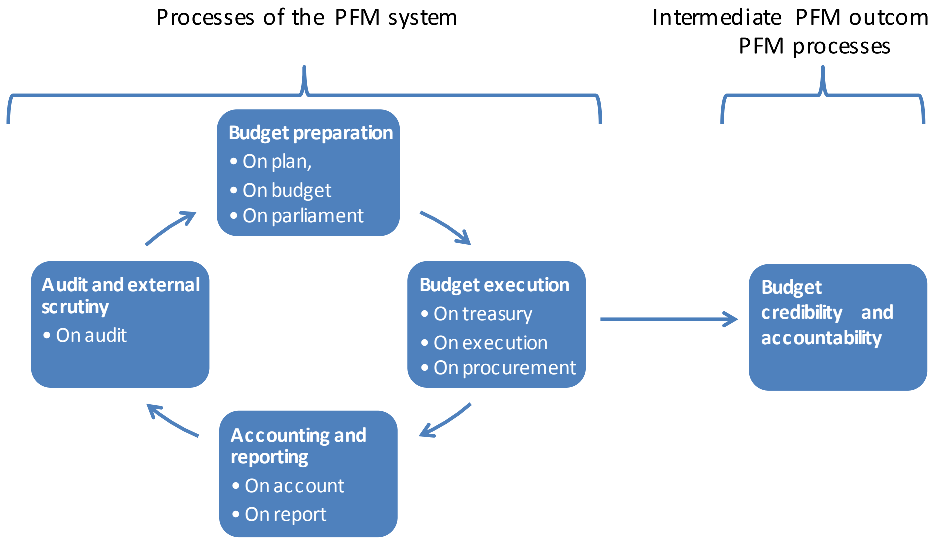
- It is the instrument commonly used at country level to assess risk by almost all development partners, even if many undertake additional assessments. Harmonised risk assessment is one of the main purposes of the framework. It is also a well-established methodology, with significant credibility, and is applied in all countries participating in the GPMF.
- It is the instrument commonly used to diagnose country PFM systems and prioritise which PFM should be strengthened for improved public financial governance and service delivery;
- Also, using PEFA means that existing data are used. However, while the GPMF is applied every second year, PEFA assessments are normally 4 to 5 years apart, on the logic that PFM improvements take time. A key choice would be whether an update will be done for the 14 indicators used specifically for the GPMF, if the latest PEFA assessment was done more than two years before the year assessed for the rest of the GPMF.

A second complication is the update of the PEFA framework, which is currently still under discussion. The update proposals include both new measures and adjustments to existing measures. This means that there will be a transition period, in which some countries' PFM indicator will use the previous framework and others the new framework. This can be managed, as long as the core fixed indicators are in both frameworks, even if their scope and/or measurement changed.

Measures

Component 1: Table 1 on page 4 sets out the proposed fixed, core measures. It is proposed that each phase of the PFM cycle, linked to the use of country systems in that dimension, is represented by one measure, except budget execution, which needs to include both financial management and procurement measures. Figure 1 below sets out the 4 key budget phase dimensions to be used, with the associate use of country systems dimensions[1]. In addition two further dimensions are proposed: these will only result if processes across the budget cycle are in place, and therefore can be described as intermediate PFM outcomes, necessary for the PFM system to result in fiscal discipline, strategic resource allocation and efficient use of resources for service delivery.

Figure 1. Six dimensions of the PFM system for measurement



Given the purpose of 9a and its relationship to 9b, the key criterion used to select indicators are whether performance against the PFM aspect being measured is more critical for development partners to use country systems, than alternative aspects. A second criterion is that the indicator selected must measure aspects that are likely to critical across countries. Further aspects that are critical to any one country will be added through Component 2 of the indicator, which allows countries to select any other indicators from the PEFA framework.

This means that the framework of fixed indicators below does not measure the PFM system overall, but specific aspects of the PFM system that are more critical than others in most cases to address the risk concerns of

[1] These draw on the original CABRI framework for measuring use of country systems across the budget cycle, adding on procurement and on execution, where the latter refers to the use of country internal controls.

development partners arising from a country's PFM systems. While addressing these concerns may not be sufficient for development partners in practice to use country systems, it is necessary.

Component 2: The proposal is that countries would select critical measures for the country aligned with targeted country PFM reforms, in agreeent with development partners at country level. An option would be to require that this component mirrors the construction of Component 1. However, the proposal is to leave it open, as countries' PFM reforms may focus more in some dimensions than in others, and the requirement for an agreement between development partners and countries on the proposed measures would assist to ensure a country-appropriate spread of measures, given PFM system weaknesses and donors perceptions of risk.

Table 1. Proposed fixed (core) measures

Dimension	Measure	Description	Discussion
Budget credibility	PI 2 Composition of Expenditure outturn, compared to original approved budget[2]	Measures extent of variance in composition of expenditure outturn over three years and expenditure charged to a contingency vote. For an A score	Predictable budget execution is critical to give DPs confidence that their cash resources will be used as planned. This measure was chosen rather than the aggregate expenditure outturn measure, as sectors can still experience variance even if the aggregate outturns are on target.
Accountability	PI 28 (iii) Issuance of recommended actions by the legislature and follow up of implementation	Measures whether audit reports result in legislative action, followed by the executive heeding legislative recommendations. An A score means that the legislature issues recommendations and these are generally implemented by the executive.[3]	Within the PEFA framework this indicator comes closest to measuring effective accountability. A functioning system as measured in the indicator will give DPs confidence that the vertical accountability loop is closed through a functioning audit (measured under the Audit and Oversight dimension) and legislative oversight system. When the legislative oversight system is functional, even if irregularities are picked up by the Supreme Audit Institutions in areas supported by DPs through country systems, DPs can have confidence that these will be addressed. An alternative measure here would be the transparency indicator PI 10, which in many countries would be a critical part of systems strengthening. However, as the fixed, core framework is proposed to measure the critical components of the system for DPs to have confidence to use it, an accountability measure is prioritised. If transparency is weak in any one country, it could be included as part of the flexible Component 2 measures.
Budget preparation	PI 12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	Measures whether multi-year fiscal forecasts and functional allocations are prepared; the scope and frequency of debt sustainability analysis; the existence of sector strategies with multi-year costing of recurrent & investment expenditure; and linkages between investment budgets and forward expenditure estimates. An A score would mean that medium term fiscal forecasts are prepared and linked to the annual allocations; debt analysis undertaken annually; 75% of primary expenditure is covered by costed sector strategies; and investments are linked to the strategies and forward recurrent cost, which is included in the strategies[4].	This indicator is important for DPs to use country planning and budgeting systems to prepare their budget proposals, for example through (sector) budget support, pooled fund using country systems or SWAp mechanisms. It measures the existence of costed sector strategies and linkages between investment budgets and forward expenditure estimates, as well as fiscal risk to predictable cash releases to ministries, departments and agencies (MDAs). An alternative indicator would be PI 11, which measures the existence of a budget process, and therefore is at a more basic level than PI 12, which measures the existence of a medium term fiscal and budget framework, and key requirements for such a framework to be functional. The preference is for PI 12, as DPs would have more confidence in the

[2] Proposed PI-2 in revised PEFA is refined by separating composition by economic from administrative/functional/programmatic classification, and thereby allowing deviation in interest payments to be measured, which sharpens the measure for the purposes here.

[3] The proposed revised PEFA framework weakens this indicator for these purposes by adjusting the second sub-dimension, implementation of recommendations by the executive, to an assessment of whether the legislature regularly follows up. However, the follow up dimension is included in PI 25, which is selected here as a fixed, core indicator.

[44] The proposed revised PI 12 does not include the dimension on debt analysis, but strengthens the measurement of a medium term financial framework and sector level medium term planning and budgeting.

Dimension	Measure	Description	Discussion
Budget execution 1	PI 20 Effectiveness of internal controls for non-salary expenditure	The indicator measures the effectiveness of expenditure commitment controls; the comprehensiveness, relevance and understanding of other internal control rules/ procedures; and the degree of compliance with rules for processing and recording transactions. An A score would mean that commitment controls are in place and limit commitments to cash availability and approved budget allocations; other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost effective set of controls, which are widely understood; and compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant[5].	Good performance against this indicator will give donors confidence that their resources will be used as intended when using country financial management systems. It measures both the quality of the controls, and adherence to them. Effective commitment controls would reduce the risk of DP resources being deviated for purposes not agreed. The existence of other expenditure controls, e.g. checks and balances before funding is committed is critical to donor confidence, as would be a culture of adherence to rules and procedures. An alternative indicator would be PI 21 which measures the internal audit system. However, PI 20 is preferred as good performance against this indicator would imply that internal audits provide incentives for effective internal control. A second alternative is PI 18, which measures the effectiveness of payroll controls. Weak payroll management can lead to the deviation of government resources to cover salaries, leaving DP resources at risk. However, PI 20 is preferred as it measures controls that would apply to DP resources, and PI 18, if an issue in countries, can be included in Component 2 of the PFM indicator.
Budget Execution 2	PI 18 Transparency, competition and complaints mechanisms in procurement	The indicator measures transparency, comprehensiveness and competition in the legal and regulatory framework; the use of competitive procurement methods; public access to complete, reliable and timely procurement information; and the existence of an independent administrative procurement complaints system. An A score would mean that the legal framework covers all the key requirements; that contracts that are awarded by methods other than open competition are justified as required by the legal framework in all cases; that 90% of procurement by value is transparent; and that a robust complaints mechanism is in place.[6]	Indicator 9b measures the degree to which donors are using country procurement systems as one of the sub-measures. It is therefore important to include PI 18, as a fixed core measure in the framework, as progress in the 9b procurement indicator would require progress against 9a.

[5] The proposed revised PI 20 clarifies the indicator by specifying which 'other' controls are critical (appropriate segregation of duties) and strengthens its measurement, for example by quantifying 'very high' compliance.

[6] The proposed revised PI 19 sharpens the measurement in these dimensions.

Dimension	Measure	Description	Discussion
Accounting and reporting	PI 25 Quality and timeliness of financial reports	The indicator measures the completeness of the financial statements; their timeliness and the accounting standards used. An A score would mean that financial reports are prepared annually, and include full revenue and expenditure and financial assets and liabilities information, are submitted for external audit within 6 months of the end of the fiscal year; and accounting standards applied to all financial reports are consistent with international standards.[7]	PI 25 is selected as good performance against this indicator – which measures a key output from the accounting and financial reporting system – would give DPs confidence to use these systems. The indicator measures both the content, underlying accounting standards and compliance with country requirements of financial reporting system. Progress against this indicator would be necessary for progress on the financial reporting sub-dimension of indicator 9b.
Audit and oversight	PI 26 Scope, nature and follow up of external audit	This indicator measures the scope/nature of audit performed (incl. adherence to auditing standards); the timeliness of submission of audit reports to legislature; and evidence of follow up on audit recommendations. An A score would mean a comprehensive audit mandate in line with audit standards; timely submission of audit reports and evidence of follow up[8].	Good performance against this indicator would give DPs confidence that vertical accountability loop is closed through PFM systems for the use of country systems in all dimensions. Furthermore, it would be key for donors to use country audit systems: progress against this indicator would be necessary for progress against the use of audit systems sub-dimension of 9b in the GPMF.

[77] The proposed revised PI 25 is strengthened by more specific stipulation on the content of financial statements, including reconciliation with approved budget, it shortens the time for submission, and has more specific requirements for the quality and application of accounting standards.

[8] The proposed revised PI 25 is strengthened through the inclusion of a dimension measuring the independence of the Supreme Audit Institution, and being more realistic in the time allowed for SAIs to submit audit reports, as well as a more specific statement on audit standards.

Scoring

The PEFA framework scoring is based on a scale of A (high performance against the indicator) to D (a minimum set of criteria met) calibrated specifically for each question. The proposed revised framework would measure from A to E, where E would indicate that the country system does not even meet the minimum set of criteria for the indicator. An option would be to use the methodology that coverts the PEFA ordinal scale to an interval scale for the framework (as has been done in a number of studies on PFM system progress), and aggregate the numbers to a single, composite score. However, that assumes equivalence in between notches between and within indicators, which may not be the case.

A second option would be to reflect the PEFA scores as is, but that would be difficult to interpret in a framework where most other measures are a single quantitative numbers.

This note sets out two further options for the scoring of 9a, using PEFA assessments, which measures change and performance in each indicator. This complies with the requirement in the GPMF that the indicator measures the strengthening of the systems, rather than the systems themselves.

Proposal 1: In this proposal the methodology is to have two components to scoring for the global fixed indicators, where improvement is not necessarily targeted.

- The **first component** would measure whether a country system is adequate for donors to use it. This would mean that using the PEFA criteria for each indicators, partner countries and development partners agree the score level that is adequate for partners to use country systems. This level, for example C in an indicator, and anything above it would score a 1, while any PEFA score below the level would earn a 0 in the GPMF scoring. A simple scale is proposed where a 1 would earned if there is improvement in the indicator, a 0 if no improvement and -1 if regression. While this is a blunt scoring instrument (a country that improves 4 notches on the PEFA scale rather than 2 would not score better), any other option would again assume equivalency between and within scores.
- The **second component** would measure the change, and would apply to the indicators targeted for improvement in the flexible component. If no change occurs, it would score a 0; if change occurs a 1; and if regression occurs, a -1.

The scores for the first component would be averaged, so as to not weight this component higher than the second component, and then added to the scores of the second component.

Proposal 2: This proposal assumes that negotiating a minimum level of achievement across countries would be considered too onerous, and therefore either the highest performance in terms of PEFA or change should be measured in a similar way across both components of the proposed 9a GPMF indicator. In this case either an A or positive change in an indicator would earn a score of 1, no change in a score below A a 0, or any regression a -1. In this case the summary score for a country would then be the sum of the scores for each indicator.

It would be important for the framework in both proposals to also to reflect the PEFA ordinal scale scores against each indicator (to assess the current level) and the change score of 0,1 or -1 against each. This would mitigate somewhat the bluntness of the proposed scoring. This is a blunt instrument, as it does not credit a country which moves from for example a C to an A, compared to a country that improves from a B to an A in an indicator. However, to measure the degree of improvement would run into the same issue with equivalency as converting to an interval scale.

Of course, using this scoring system would mean that in the first application, higher effort will be required to establish a baseline if only one PEFA assessment has been done.

Process

The use of a flexible indicator will require a country process to agree which indicators are selected. This would need to occur at least two years in advance of the first measurement of the revised 9a, or alternatively the first measurement of a revised 9a would only measure component 1, and include a process to measure component 2. The agreement should be reached between the country and all development partners either agreeing to increase their use of country systems, or supporting PFM reforms. Where possible existing PFM / use of country systems coordination structures should be used.

4. Questions

Key questions for feedback on this note are as following:

1) Do you agree with the construction of the indicator, having a fixed and a flexible component?
2) Do you agree with the use of PEFA?
3) Would you support an update on the indicators selected if the most recent PEFA assessment is more than two years old?
4) Do you agree with the measures proposed for the fixed, core component? What alternative PEFA measures would you propose? Should PI 10, which measures transparency, be included in the fixed, core component?
5) Do you agree that there should be an equal number of measures in the fixed, core component and the flexible country-specific component, and that all measures should be weighted equally?
6) Do you agree that the flexible component should be open and not pre-select aspects of the PFM system requiring equal distribution of measures between the aspects?
7) Do you agree that the PEFA scores as is should be used to develop a single numerical score rather than just reflecting the ordinal PEFA scale scores? Do you agree that converting them consistently to an interval scale of 1 to 4 (or 5 for the revised framework) should not be done?
8) Do you think that Proposal 1 (which measures both adequacy of systems and change in a way that is sensitive to minimum average development partner requirements to use country systems) should be used to score, or proposal 2 (which measures either highest performance rather than adequacy, or change)?
9) Do you agree that a country level process is feasible and necessary to agree the content of component 2 of the proposed indicator?

Respondents are welcome to add further comments not covered by these questions.