QUESTIONS FOR CONSULTATION, August 7, 2014

Please send your comments to services@pefa.org

The PEFA Partners look forward to receiving your feedback—a crucial element in finalizing the updated version of the PEFA indicator set—by October 31, 2014, at the latest. While we welcome feedback on any aspect of the draft, we are specifically interested in your comments on the key items below. Thank you for your cooperation!

CONTACT INFORMATION

When submitting your comments (**services@pefa.org**), please include the following information, which will enable us to understand your stake in the PEFA Framework and, if need be, allow us to contact you for further details related to your comments.

Name	Dr. Jesse Hughes
Function	Chair, International Accounting Standards Committee
Organization	International Consortium on Governmental Financial Management
Address	P.O. Box 1077, St. Michaels, Maryland 21663, USA
Phone number	410 745-8569
E-mail address	icgfm@icgfm.org

QUESTIONNAIRE

1. In your opinion, are the following changes introduced in the draft updated indicator set relevant? Is the suggested formulation adequate? Please provide comments to support your opinion that could help us improve the draft version.

		Relevant			Adequately formulated (Y/N)	Comments
		Fully agree	Partially agree	Disagree		
Introduction of new indicators						
	PI-CFS	**X**			**Y**	**None**
	PI-PIM	**X**			**N**	**Would like to see more emphasis on cash management. Also, see note 6b below.**

		Relevant			Adequately formulated (Y/N)	Comments
	PI-PAM	X			N	Would like to see more emphasis on management of public enterprises since they comprise large transfers in some countries.
Removal of indicators						
	PI-4	X			N	See note 2i on PI-17 below.
	D-1	X			Y	None
	D-2	X			Y	None
	D-3	X			Y	None
Replaced/restructured indicators						
	PI-7	X			N	See note 2b below.
	PI-12	X			Y	None
	PI-13	X			N	Cash paid directly by third parties should be separately identified as required by IPSAS. Also, see note 2g below.
	PI-14	X			N	Revenue from exchange and non-exchange transactions should be separately identified as required by IPSAS.
	PI-15	X			N	See comments to PI-13 and PI-14 above.
	PI-20	X			N	See note 2j below.
	PI-22	X			Y	None
	PI-23	X			N	Comparisons between actual and revised budget should also be assessed. This comment also applies to PI-24. Also, see note 2l below.
New dimensions added to existing indicators						
	New PI-2(ii)	X			Y	None
	New PI-9(ii)	X			N	Assessment should consider the IPSAS requirements of reporting for PPPs, AGAs and PEs. Also, see note 2d below.
	New PI-21(iv)	X			N	See note 2k below.
	New PI-26(iv)	X			N	See note 2n below.
	New PI-28(iv)	X			Y	None
Removed dimensions						
	PI-17 (iii)	X			N	See note 2i below.
Shifted dimensions						

		Relevant			Adequately formulated (Y/N)	Comments
	PI-4(ii) to new PI-17(ii)	**X**			**N**	**See note 2i below.**
	PI-9(ii) to new PI-8(iv)	**X**			**N**	**See note 2c below.**
	PI-11(iii) to new PI-27(iii) + vice versa	**X**			**N**	**See note 2f below.**
	PI-17(ii) to new PI-16(i)	**X**			**N**	**See note 2h below.**
Changes to score requirements in other indicators/dimensions						
	PI-5	**X**			**N**	**See note 2a below.**
	PI-10	**X**			**N**	**See note 2e below.**
	PI-25	**X**			**N**	**See note 2m below.**
Default for 'D' ratings ("does not meet requirements for score 'C' or higher")		**X**			**Y**	**None**

2. Are there other issues the draft version of the updated indicator set does not address or cover adequately? What are they? How could they be better addressed or covered? **Response—Our thoughts on the specific indicators are as follows:**

a. PI-5

Reference is only to GFS reporting. But the classification should also enable reporting according to IPSAS. This also requires that the budget and accounting classifications are consistent.

b. PI-7

The explanation should mention departmental revenues that are not brought to account, e.g. school and university fees, receipts on sale of drugs and medical services, etc. These are often significant and should be reported centrally ex ante and ex post even if the receiving agency has the right to retain and use them, so they can be included in the overall budget and accounts. The indicator has been correctly reclassified as M2 as the new dimension (ii) is independent of dimension (i)

c. PI-8

In PI-8 (iii), consolidation after 12 months is of little value for decision making purposes.

Dimension PI-8 (iv) is a copy of the old PI-9 (ii) on the extent of central government monitoring of SN governments' fiscal position. The wording of the old PI-9 (ii) is flawed in that the rating criteria do not explicitly include informal borrowing through temporary overdrafts and expenditure arrears by SN governments. It is commonly found that SN governments are statutorily prevented from formal borrowing, or subject to prior central government approval of formal borrowing, but this is evaded by informal borrowing by bank overdraft or supplier/contractor credit. The amounts may be significant. PEFA Secretariat reviews of draft PEFA reports commonly question A scores allowed for this dimension on the ground that SN government cannot generate fiscal liabilities for central government. They can always generate fiscal liabilities, and these constitute a fiscal risk for central government.

d. PI-9

The indicator has been correctly reclassified as M2 as the new dimension (ii) is independent of dimension (i).

e. PI-10

Audited annual financial reports should be available to the public within 9 months after the end of the fiscal period if they are to be of any value.

f. PI-11

The new indicator covers political participation in budget preparation (as before), but not private sector and civil society participation, which is probably more important. This could be made the subject of a 4th dimension and include requirements for government to consult with representative institutions and focus groups at a suitable stage in the budget preparation process, issue of citizen's budgets, gender budgets, etc.

g. PI-13

The former PI-13 (transparency of taxpayer obligations and liabilities) has been moved to PI-14 (revenue administration compliance). The new PI-13 is concerned with revenue forecasting. Dimension (iii) requires calculation of the variance in revenue composition, but does not specify the level of detail. It is suggested that this should be the GFS 3-digit level (taxes on income, taxes on payroll, taxes on property, taxes on goods and services, etc.—a maximum of 15 line items). This level is necessary to provide a meaningful decomposition and to distinguish external grants from domestic grants.

IPSAS requires disclosure of resources provided and amounts expended by third parties on behalf of the reporting entity without going through the reporting entity's accounts. This covers expenditures made by donors on capital projects, funded by grants and loans, which are significant in most developing countries. This is covered by PI-25 (iii).

h. PI-16

No mention is made of the Statement of Cash Flows required by both the GFSM and the IPSAS although it is covered in PI-25. A separate dimension (similar to PI-2 for budget results) would be beneficial to compare over time the cash flows for operating, investing, and financing activities as well as the beginning and ending cash balances over a three year period.

i. PI-17

This indicator now includes expenditure arrears, which are also debts. In some countries, arrears have to be verified, e.g. internal or external audit. In such a case, if they are past their due date they are still arrears. They have to be included in debt records to score A or B. The C score allows that there may be gaps.

Dimension (ii) focuses on the system for monitoring arrears, and a table must be completed showing the actual stock of arrears at the end of each of the last 3 years. The amount of arrears or its percentage to total expenditure is no longer relevant for scoring as arrears are included in overall debt and are covered by the new CFS indicator.

The IPSAS standard requires mandatory disclosure of committed undrawn external assistance, loans and grants separately. This is covered by PI-25 (iii).

j. PI-20

This indicator has been restructured to give greater emphasis on segregation of duties, which is welcomed. However, it can be dimension (ii) rather than (i), to preserve more of the old structure. Dimension (i) on commitment control could remain as before. The indicator has been correctly reclassified as M2 as the dimensions are independent of each other.

Dimension (iii) requires a calculation of how many payments are executed in accordance with the rules. It is not clear whether this applies to the number of transactions or their amounts. In any case, the dimension is not measurable within the context of a PEFA assessment. In the old framework, this was not quantified: an A required that compliance was “very high”, a B that compliance was “fairly high”, C that there was compliance “in a significant majority of transactions”. The assessment of this dimension is very dependent on the quality of audit and the professional judgment of the assessors. Subjectivity can be reduced by use of internally generated measures, such as the % of financial reports free of material misstatements (as in South Africa) and by better training of assessors and more systematic reconciliation within and between assessment teams, but subjectivity is not wholly avoidable. If assessors are not willing to make ‘professional judgments’, there will be a high proportion of NR ratings for lack of information.

k. PI-21

The restructuring of the indicator into four dimensions is supported.

Dimension (iii) requires evidence of follow up of internal audit findings by management of 80% of the entities audited in the last financial year. Audits completed (and reported on) in the last financial year may be too recent for assessing management response. The dimension wording should allow sufficient time for effective follow up and the collection of evidence of this. The critical period/time in the old PI-21 (iii) was “Latest available financial and operational information”.

Recommendation: Retain the same critical period/time in the forthcoming Field Guide, and change the wording to “There is clear evidence of effective and timely follow up of internal audit findings by management “.

In dimensions (ii) and (iii) the calibration is not even. The requirement for a B rating should be 65% not 67%.

l. **PI-23**

This is the most important addition to the PEFA framework. PI-23, which used to be focused only on information for resources received by primary health clinics and primary schools (irrespective of how they were used), now covers all phases of performance management, with equal attention to physical and financial measures. It is the only PEFA indicator that addresses physical performance (all the others are concerned only with money).

It is also expanded to cover *all* government services. This is very ambitious. The assessment team would in most countries have to investigate the performance budgeting and monitoring systems in health, education, social security, police, road construction and maintenance, energy, water, sanitation, passport issue, licensing of manufacturers, traders, drivers, restaurants… in fact, almost the whole of the COFOG list. Only a few countries have centralized and comprehensive systems of performance management, and in any case, assessors would need to examine supplementary sectoral information systems also. Many countries have a multiplicity of monitoring systems (e.g. Uganda), so the first PEFA assessment in such a country would require a cross-government review of the whole monitoring function so as to establish a methodology of assessment. Assessment would require considerable extra time and resources, perhaps double present levels.

Recommendation: consider option of continuing to cover only health and education.

On this subject, IPSASB has recently issued a Recommended Practice Guideline, RPG 3: Reporting Service Performance Information, with recommendations on presentation. Though this is a guideline, not a mandatory standard, the new PEFA framework designers should take note of it and harmonize with its terminology, etc.

m. PI-25

Dimension (iii) refers to the financial reports for budgetary central government. This requires the consolidation (in a decentralized system) of the separate financial statements of MDAs, but not the consolidation also of other parts of central government, such as extra-budgetary development funds (e.g., the South Africa Reconstruction and Development Fund), state-owned sovereign wealth funds, contingency fund, social security funds, other special funds, and autonomous government agencies controlled by central government but not within the main budget. It is recognized that the framework cannot at present be applied to the whole of central government, and that ‘budgetary central government’ is a more practical boundary. This term (which is not in GFS) should be defined in section 1 of the Performance Report and included in the table showing the composition of general government.

Dimension (iii) is about the application of accounting standards to all financial reports. A and B ratings require that the accounting standards are consistent with international standards. Several governments claim to apply cash or accrual IPSAS, but do not fully meet the standards (particularly on the extent of consolidation). Ideally, consolidated financial reports should be included especially for budgetary entities, extra-budgetary entities, and GBEs. Clarification is needed that A and B ratings apply only if standards are met, not that they are the official benchmark or aspiration.

Further, the adequacy of an accounting law should be assessed to supplement the budget law that is evaluated in PI-27.

n. PI-26

Dimension (ii) on timeliness of audit reports to the legislature is looser than before.

	AFS submitted to audit (months from end of year)		Audit report to legislature (months from receipt of AFS)		Total time from end of year (months)	
	OLD	As proposed	OLD	As proposed	OLD	As proposed
A	6	3	4	6	10	9
B	10	6	8	9	18	15
C	15	9	12	12	27	21

With increasing use of continuous audit (not waiting till the year is over before starting its audit), the standard could be similarly tightened, e.g. to 3 months (A), 6 months (B) and 9 months (C). Audit reports would then be presented to the legislature within 6 months of the year end (A), 12 months (B) or 18 months (C). An A rating would ensure that the budget for year t+1 would be informed by the audit of year t-1. An A or B rating would also fit with the requirement of PI-10 for an audited annual report within 12 months of the year end.

Recommendation: tighten up audit completion to 3 months for an A, 6 months for a B, and 9 months for a C. audit report on t-1, thus reducing the accountability lag.

3. Could you share your views about the arrangements presented in the accompanying note to support comparability over time? Do you have any suggestions to complement these arrangements? **Response—The comparability arrangements are adequate and we have no suggestions for change.**

4. Could you share your views about the transitional arrangements presented in the accompanying note? Do you have any suggestions to complement these arrangements? **Response—The transitional arrangements are adequate and we have no suggestions for change.**

5. Would you like to share any other comments on the draft updated indicator set? **Response—This is a major step forward in measuring the state of PFM, though there will be significant operational problems. The PEFA effort is moving the world toward better transparency and accountability. We applaud the PEFA partners in their efforts to meet these objectives. We would like to see more emphasis in the PIs on Cash Management since the availability of funds is critical to a country's success. We would also like to see more recognition of the cash and accrual IPSAS since there needs to be close harmonization between the GFSM and IPSAS. Further, we would like to see the need for close interaction between the public enterprises and Central Government since many countries rely on these PEs to supplement their budgets.**

6. Do you have any suggestions for the overall update of the framework, including, for example, the organization/grouping of the indicators, the format/content of the PFM Performance Report, the Summary Assessment, and the general guidance provided in the Framework booklet? **Response—Additional comments on the Updated PEFA Framework are as follows:**

a. General

The existing three budgetary outcomes are retained "and consideration will be given to recognizing financial compliance as a separate outcome". Not sure what this means. One could say that the whole of the framework is measuring compliance with international standards. The CFS iii and PI-1 to 3 indicators measure compliance with nationally authorized components of the budget. Compliance with laws and regulations on processing and recording transactions is covered by PI-19 ii and PI-20 iii; compliance with reporting standards is covered by PI-24 and 25; and compliance with audit recommendations is covered by PI-21 and 26. There are of course measurement problems in PI-19, 20, 21, 24, 25 and 26. (see PI-20 under paragraph 2 above)

The indicators do not address civil society participation in the budget and reporting processes.

<u>Recommendation</u>: Drop reference to financial compliance as an outcome and include civil society participation in the processes.

b. PIM

This is an excellent addition to the framework. One interesting innovation in the framework is the reference to “estimates of work in progress” in dimension (iii). In cash-based accounting, there is no work in progress. In accrual accounting, work in progress consists of advances to contractors in excess of work done and certificated, less creditors for supplies. The requirement for an A rating depends on full accrual project accounting.