Development and Public Financial Management - Action Items

Recommendations

Strategic Outcomes

Put in place a development strategy based on key Government priorities and the economic, social and security outlook.

Prioritize efforts to ensure the sustainability of the budget.

Engage the donors on the budget reform process with a view to consolidating the budget and creating some flexibility.

Institute a comprehensive reform process for the budget led by the MOF.
Begin the process of aligning institutional arrangements to support reforms.

Immediate Next Steps

Step 1: Road test the findings of the review with the MoF leadership group to validate the diagnosis of the problems and agree on the solutions – DMs and DGs;

- **Comments from MOF** Policy (and others as determined) received on draft papers **by 7 April** (current version of paper circulated to other MoF areas as determined)
- **Update papers** for comments from President and MoF finalized **by 7 April**.
- **Final papers distributed on 8 April** in preparation for MoF workshop.
- **MoF workshop on 13 April to discuss findings** of the review and kick start PFMR process.
- **Workshop 11 May facilitated discussion** of FRA and PFMR priorities (Andrew and Vin potentially could come back for this).
- **Validation workshop on 25 May to reach consensus** on PFM Roadmap priorities and way forward, including responsibilities and timelines (in preparation for Step 3-7).

Step 2: Brief donors on progress and give them the opportunity to comment on technical papers;

- **Provide donors with final papers by 8 April** and ask them for written submission for the 13 April workshop.
- After each workshop brief the donors on progress.

Step 3: Establish a team to take responsibility for analysing and establishing in-house capacity for quantifying and tracking quality of Afghan PFM systems and fiduciary risks (monitoring and evaluation);

- **Minister for Finance initiates a process for MoF restructure** that includes DMs and DGs in order to support the PFMR process.
- Proposed structure discussed at 13 April workshop and finalised at 25 May workshop.

Step 4: Agree with internal and external stakeholders on the key next steps (steps 5 to 7);

- **Agreement to be reached at the 25 May** workshop including on priorities and responsibilities for Steps 5-7

Step 5: Start to develop a well-sequenced rolling annualized 5 year rolling PFM Reform program that clearly outlines actions to be done by each unit within MoF, and sets output targets and specifies aspirational outcome/international benchmarks;

Step 6: Start with analysing all options for technical and political feasibility and follow the PEFA – Diamond approach to sequencing PFM reform;

Step 7: Develop a team based performance management system[i] designed to help MoF manage the reform process including through a regular process of rating team performance and integrating the Diamond approach to PFM reform sequencing; and

Step 8: Work towards more flexible on-budget aid based on clear understanding of mutual obligations between donors and GoIRA, including based on well tested aid policy framework.

Actions / questions / issues arising from the review

Over-Budgeting

- **The dominance of multi-year financing grants** without a system to track maturities and establish annual and multi-year budget disciplines;
- **Disorderly internal budget processes** leading to non-strategic decision making;
- **A high tolerance for mediocrity – due to a reluctance to say no to** any sort of assistance;
- **Fragmented development and operating budgets** and poor comparability of budgets and accounts;
- **Ineffective allotment and commitment process** for cash control process;
- **Under-utilization of ex-post controls** (after a transaction) and over reliance on ex-ante controls (before a transaction occurs);
- **Lack of line agency control of AFMIS functions** resulting in a multiplicity of accounting systems and perverse incentives;
- **A long history of not having any real cash constraints** meaning that over-budgeting had no serious consequences;
- **A policy of balanced budgeting** – meaning that cash reserves could be built up over time and not credibly used to finance budget deficits; only in-year revenues could finance budget expenditures;
- **Growing budgets too quickly** – constraining absorptive capacities of spending units;
- **Continuous improvement cycle not in place or is very weak** – this is the system of accountability where Minsters defend their promises and the results of their ministries – the systems that hold Ministers accountable for their performance; and
- **Pro-active involvement by some members of parliament** in development budget preparation and execution – compromising the ability of Cabinet to set and implement a coherent budget strategy.

Numerous rigidities in spending control systems

Weak budget credibility is also a function of rigidities in the spending control systems. There are clear and significant rigidities in the following spending control systems:

- The allotment (warrant) process to ensure cash is managed well and appropriations are not breached (at spending unit/appropriation level);
- The reservation of funds for priority and earmarked purposes (normally secondary spending units, programs and/or projects not covered by a separate multi-year financing agreement)
- The procurement process for specifying procurement terms and awarding contracts, publishing information and dealing with complaints;
- The commitment/obligation establishment and clearance process to ensure funds are available to meet contractual obligations;
- The contract management process for ensuring: i) assets, goods and services are delivered on time and to standard (quality and quantity); ii) invoices are tracked; iii) valid invoices are paid on time; and iv) assets and inventory stocks are recorded.

Insufficient rigidities in spending control systems

- **Full integration of procurement and contract management** means that many more steps are recorded on the system: i) contracts cannot be legally entered into unless electronic approvals have been granted (by people not involved in the procurement process); ii) procurement disclosure requirements are met automatically (through procurement transparency portals); iii) contract records are electronically filed on the system; iv) commitments and commitment liquidation is clearly linked to contracts and contract terms; v) supply verification is recorded on the system; vi) invoice dates and invoice receipt dates are tracked on the system (reducing bribery incentives through increased detection capabilities); and vii) reconciliation of payments made (including receipts for payments made).

- **Full integration of procurement and contract management functions has already been achieved with Afghanistan's AFMIS brand in other settings**. In Timor-Leste, full integration was achieved within 12 months, which also involved significant training of the additional procedures that went with the roll-out of control of commitment, procurement and contract management system to budget holders. It should be noted that there was an initial cost to such a move: The first six months when the new system went live, budget execution performance slowed down significantly. That was corrected relatively quickly after finance mangers in line agencies accepted that they needed to learn and use the system properly – especially if their contractors were to get paid.

- **For the purpose of this preliminary report, the next sections only briefly summarise the issues in other parts of GoIRA's PFM systems**. For discussion of general issues with the topic, the reader is referred to PEFA and related guidance material.

Transparency

- **Reform efforts have been successful in making Afghan budgets more transparent** as measured under the Open Budget Index (OBI) (see **Error! Reference source not found.**);
- **Fragmented budget and accounting classification and reporting standards** is causing opaqueness in the purpose of spending making it difficult for stakeholders to hold government to account for performance and difficult for decision makers especially cabinet to make good decisions;
- **Insufficient disclosures** - the Budget papers are not good enough making it difficult for stakeholders to understand the intended purpose government budgets, especially in terms of inputs, outputs and outcomes;
- **Lack of disclosure on provincial allocations** and resource allocation rules – causing allocations to the provinces to be more opaque than it can be. In particular, central and general government sector budget consolidations are too opaque**.**

Medium-term Strategic Budgeting

- **Development risks and significantly higher than fiduciary risks** in this strategic area.

- **Macro-fiscal and sector baseline modelling and scenario analysis is not working** to feed into budget strategy setting systems properly;
- **Budget preparation system is focused more on aggregation** and not well linked to policy or serious quality control of budget estimates, especially associated with development budget project estimates;
- **The approach to establishing a medium-term perspective is taking the long road**, with a focus on first establishing internal forecasting performance and macro-fiscal models, and avoiding adoption of medium-term appropriation control systems; and
- **The Government has not prioritized the function - there are no civil servants** in the Fiscal Policy Unit (FPU) - all staff are economists are contractors engaged on Making Budgets and Aid Work (MBAW), funding for which may well stop in the near future.

Taxation System

- **Published tax revenue forecasts have been very inaccurate** for many years
- **The system for assessing tax, tracking tax arrears and collecting debt is weak** and remains under development (including for customs related taxes);
- **Tax audits are yet to deliver** significant revenue results or successful prosecutions;
- **Tax reconciliation systems are not working** routinely to accurately check that monies expected, owed, and received balance and with differences investigated and explained routinely;
- **Institutional anti-corruption plans are underdeveloped to mitigate risk of capture** between tax payer, tax officials and import/exporters and customs officers (with recent anecdotal reports of increased facilitation payments at the borders as a results of political uncertainties and weak remuneration arrangements);
- **The reach of the tax system is minimal**, with very few tax offices (buildings and staff) established in the provinces, and with information management system linkages only in place in in Kabul;
- **Separation of tax policy and tax collection has not yet been prioritized** – a credible plan will need to be developed; and
- **Remuneration arrangements for tax officials and capital plans for offices are insufficient to deliver the right incentives to collect all tax owed to government** – a credible plan will need to be developed and financed.

Non-Tax Revenue

- **Systems for the collection, remittance and reconciliation of fees, fines and charges** are weak, especially key areas including Police, Customs, and Judiciary (with the Mining sector making good progress in recent years);
- **The Extractive Industries Transparency Initiative (EITI) is making good progress**, but will need to be activity supported for many years.
- **Modelling of short and long-term mining revenues needs to continue** in-house within the Ministry of Mines, Fiscal Policy Unit and the Tax Department.

Predictability and Expenditure Control

- **Systemic problems in the allotment and commitment processes – with no authority provided to budget holders to use the accounting control system** for these key transactions is slowing down and reducing the quality of spending (see also the section on **Error! Reference source not found.** on page **Error! Bookmark not defined.**);
- **Cash management is yet to deliver expected results** – past performance resulted in high levels of idle cash balances, at times when cash was not constrained, and current systems to manage cash, under cash constrained times, are drawing on blunt instruments (see **Error! Reference source not found.**on page **Error! Bookmark not defined.**);
- **Implicit government guarantees can easily be issued through non-central means**, increasing fiscal risks;
- **The size and cost of the public service wage and consulting bill is opaque** and is at risk of getting out of control, compromising the sustainability of budget; and
- **Systems to deliver high levels of compliance with existing rules are not yet working well** enough.

Procurement

- **e-Procurement is not yet rolled-out and current plans do not involve two way integration with AFMIS** and linkages to procurement and financial transparency portals;
- **Contract management is handled outside of AFMIS** increasing risks significantly. These include systems for verification and inspection at receipt of goods and services procured, tracking dates and receipts of invoices, and monitoring upstream work such as specifications and feasibility studies, and downstream work such as contract revisions and cancellations;
- **Forensic IT based auditing of procurement risks is constrained** by lack of linkages of procurement, contract management and accounting systems.
- **Systems and legislation to monitor and manage conflicts of interest** in procurement are still under-developed, including for involvement of contractors and members of parliament;
- **Complaints systems have improved, but further work is required** to ensure assessments are fair and referrals and sanctions work as intended;
- **The current approach to centralized procurement appears to focus attention** on some of the current highest risks within the procurement cycle including conflicts of interests in the awards of large value contracts, establishing hurdle approaches for empowering spending units based on performance, and improving oversight of procurement activity.

Internal Audit

- **Variable capacity across ministries to undertake internal audit in broad compliance with international internal auditing standards** (ISPPIA) –with unclear strategy how broad compliance with be secured over time;
- **Existing reporting mechanisms to the Supreme Audit Institution compromises the independence of internal auditors**, reduces the incentives for Ministers to allow internal audit to work as intended (as an early warning service) and is in conflict with INTOSAI (supreme audit institution auditing) and ISPPIA (internal auditing) standards.

- **Reports of recent use of internal audit systems by the Government are encouraging**, including appropriate planning, response, and follow-up on confidential matters, and referral of certain matters to the appropriate authorities.

Accounting Recording and Reporting

- **In-year reporting is good enough** to enable decision makers to respond to issues in a timely and effective manner –but comparability of budgets and accounts remains a key development risk;
- **The effectiveness of bank reconciliation performance is constrained** by the lack of use of sub-accounts in the Treasury Single Account (TSA), meaning cash accounts are not established for spending units. This results in a high tolerance for irregularities since the cash balance is the whole of Treasury Single Accounts (less special accounts of donors). Lack of sub-accounts makes it difficult to devolve accounting and reporting powers to spending agencies (e.g. Financial Statements including a balance sheet for the Ministry of Education are not really possible without a separate cash balance account). The lack of sub-accounts also makes it difficult to target bank reconciliations, where systems for flagging fiduciary and procurement risks can be put in place for particular spending units.
- **Accounting or classification standards have not been established**, with no reference to IPSAS-cash standards for accounting (and reporting) and GFS-cash standards for classification (and accounting and reporting) and national accounts construction. In particular, a plan to comply with GFS-cash and IPSAS-cash is not yet in place, including plans for adoption of many of the voluntary but still very important IPSAS-cash standards.
- **Only Qatia (legacy style) statements are produced and submitted for external audit and transmittal to parliament.** IPSAS-cash and GFS-cash style financial statements appear to be produced only for information purposes. Audits on the reliability of the published IPSAS and GFS style financial statements are not available.
- **There appear to be no plans to have IPSAS-cash and GFS-cash style financial statements produced and audited for large spending agencies**, significantly increasing fiduciary and development risks and compromising accountability and continuous improvement cycles.
- **Lack of access to AFMIS by line agencies has created multiple accounting systems**, with different standards throughout the Government, and has disempowered spending units.

External Audit

- **Compliance with auditing standards for supreme audit institutions (INTOSAI) is limited** to historical practice provisions; and
- **There appear to be no plans to have IPSAS-cash and GFS-cash style financial statements produced and audited for the government as a whole, as well as for large spending agencies**, significantly increasing fiduciary and development risks and compromising the accountability and continuous improvement cycles.

Parliamentary Scrutiny

- **The standard democratic system used in the system to hold Government account for its fiscal performance is not working** – i.e. where defending of budgets is performed by the Government through Budget Committees – as chaired by Government aligned members of parliament, and criticising Government performance is undertaken by an opposition through a Public Accounts

Committees – chaired by a member of the Opposition. The system is not yet in place partly as a result of a lack of a formally organised opposition block.

- **The extent to which Afghanistan can leap frog normal development paths to establish a system of opposition is unclear**. Options include electoral funding for political parties and funding for oppositions and parliamentary committee secretariats. Such funding mechanisms help, inter alia, to reduce the costs of losing elections leading to higher probabilities of political stability and controlled transfers of power and a deeper respect for the rule of election law.

Banking Supervision

- **Broad non-compliance with Core Basel Principles** exposes the government to avoidable fiduciary, development and fiscal risks.

Donor Practices

- **Development risks are significantly higher than fiduciary risks** in this area;
- **More reliable estimates of annual budget support** levels used to finance annual budgets is needed to reduce development risks;
- **More genuine budget support can deliver better development results** when the conditions are right;
- **A better balance of different budget support types** (including direct, earmarked, program, agency, sector and general) also help deliver better development results at lower cost;
- **Better compliance with the primary classification system** used by government is needed for project based aid; and
- **Increased support for defragmentation** of development and operating budgets is needed.

Budgeting

- **Forecast domestic revenues conservatively in the budget,** until patterns of future revenue growth can be more reliably predicted. Budgeting for revenues that cannot be raised will lower execution rates.
- **Undertake joint analysis with donors of why specific donor project budgets are consistently over-budgeted**, and identify an approach to ensuring annual project budgets are realistic. This may include adapting the budgeting, procurement, and management arrangements of donor projects to ensure they follow the government's annual budget cycle more closely. More accurate estimates may be helped by having sectoral coordination meetings between all donors in a sector and line ministry and MoF staff; and by holding meetings with individual donors. Analysis of past years' budget performance should inform these meetings, so that projects which are consistently underspending their budgets are identified.
- **Restrict carry forward budgets (especially discretionary projects),** and make it easier for donor-financed projects that estimate more conservatively to access additional budget during the year if they are able to spend more.
- **Analyze the system for deciding on transfer of budget from one budget line to another more closely, to ensure that it is a streamlined as possible.** Establish anticipated

timelines. Prepare guidelines for line ministries and MoF staff. Socialize the guidelines widely through workshops for line ministry finance staff.

- **Consider publishing provincial allocations (including of the operating budget) more transparently in the budget** (although not appropriating to the level of those allocations).
- **A more robust multi-year focus is needed for the budget, and the development and operating budgets need to be integrated.** More work is needed to identify the specific elements of that process. A good place to start might be considering why program budgeting has not brought this focus to the budget. A number of previous studies have considered these questions and should be reviewed to see if their recommendations remain relevant. At minimum, this multi-year process should track multi-year expenditure estimates for the life of an activity. Budget negotiations should be focused on changes to the baseline of ongoing activities.
- **Introduce more top down guidance in the budget process,** in line with strategic direction of government. Ministry guidance should emphasize efficiency in project preparation, minimizing the number of small projects.

Budget execution

- **Institute systems to measure time lines for key budget and payment approval processes to facilitate analysis of whether service standards are being met.** Introducing recording of the date of invoice receipt would allow monitoring of how long suppliers are waiting until they receive payment.
- **Undertake more in depth analysis of planning processes that inform budget estimates** (within line ministries, and within MoF) and develop specific proposals for improving the accuracy of activity planning and costing.
- **Undertake analysis of the data set generated by the ARTF monitoring agent** (or request the World Bank to undertake specific analysis) to identify with more precision areas of weakness in budget execution generally, but in procurement specifically.
- **Undertake evaluation of what has been achieved from support to procurement capacity and system development** (including the placement of procurement controllers, use of IT systems, and assessment of staff capacity) as a basis for developing the next phase of support to procurement.
- **Undertake a credibility analysis of procurement plans (perhaps in selected ministries),** to identify with more precision where procurement planning is inaccurate (which ministries, what kind of contracts or projects) and develop a plan to improve
- Mandate the use of PMIS. Explore options to link it to AFMIS
- **Evaluate options for moving to e-procurement,** including using the e-procurement module of Freebalance.
- **Clarify new procurement arrangements** (including thresholds, and roles and responsibilities of line ministries and the new Procurement General Directorate), issue a

circular, develop guidance and socialize the guidance widely and begin the process of changing procurement culture within line ministries.

Shifting from ex ante to ex post controls

- **Undertake more in depth analysis of budget execution approval processes** both within line ministries and within ministry of Finance. The review should focus on:
    - additional approval processes in line ministries;
    - the allotment process (including where it should be managed and when in the execution chain it should take effect);
    - allowing line ministries to undertake some transaction entry in AFMIS;
    - how line ministries manage budget execution internally, including how their bespoke systems interact with AFMIS;
    - streamlining approval processes within line ministries;
    - more efficient use of internal ministry financial delegations.
- **Explore how line ministries are managing financial delegations,** and develop guidance and an executive development program to help ministers in the new government make delegations in a consistent and efficient manner, and hold financial delegates appropriately accountable. This guidance should also cover the use of internal audit to reinforce line ministry control systems.
- **Undertake further analysis of options for delegating increased financial responsibility to provincial directorates** and execution through mustofiats, particularly for basic operations and maintenance expenditures.