

Malawi: Report on the Observance of Standards and Codes—Fiscal Transparency Module

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MALAWI

Report on the Observance of Standards and Codes (ROSC) Fiscal Transparency Module

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July 26, 2002

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in Malawi in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire, other documents provided by the authorities, and discussions during the FAD mission from September 9-21, 2001 and subsequently.

A number of improvements have been made to budget management in Malawi in recent years that are increasing the level of fiscal transparency. Notable examples include the development of a sophisticated budget classification system, the introduction of the Medium Term Expenditure Framework (MTEF) budgeting process and the potential contribution from the implementation of an Integrated Financial Management Information System (IFMIS).

However, the developments have not been applied consistently across the different areas of fiscal management and there has been insufficient attention to data quality. Further work is required to broaden and deepen the level of fiscal transparency. In deciding the short-term priorities, preference is given to building on existing donor-supported developments. The priorities are to improve:

- **The reporting of fiscal information** – at present some significant fiscal information is not provided to parliament or is only included in the annual accounts, and as a result is not provided in a timely manner.
- **The legislative environment** – the lack of statutory backing poses a risk to the ongoing transparency effort. The current review of the Finance and Audit Act 1966 provides an opportunity to strengthen the fiscal reporting requirements by making the provision of some existing and proposed reports a statutory requirement.
- **The quality of fiscal data** – the quality of fiscal information is compromised by weak internal control systems, the inadequate maintenance of formal recording systems, and significant delays in the information being released. While the ongoing implementation of IFMIS should assist the authorities, greater effort will be made to improve the administrative systems that support financial management.
- **The budget preparation process** – the budget has not been a reliable guide to the likely fiscal performance of the government. In refining the operation of the MTEF, the budget preparation process will be reviewed to encourage more open discussion of the important judgments and wider ownership of the budget itself.
- **The privatization process** – some basic principles of public financial management and transparency should be re-asserted. Proceeds should be recorded on a gross basis.
- **The transparency of local government activities** – with the government committed to a substantial decentralization program the current weakness of financial management at the lower level of government needs to be addressed.

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ABBREVIATIONS AND ACRONYMS

ADMARC	Agricultural Development and Marketing Corporation
DFID	Department for International Development
IFMIS	Integrated Financial Management Information System
MOFEP	Ministry of Finance and Economic Planning
MRA	Malawi Revenue Authority
MTEF	Medium Term Expenditure Framework
NSO	National Statistics Office
PERMU	Parastatal Enterprise Reform and Monitoring Unit
PRSP	Poverty Reduction Strategy Paper
RBM	Reserve Bank of Malawi

I. INTRODUCTION

1. This draft report provides an assessment of fiscal transparency practices in Malawi against the requirements of the IMF *Code of Good Practices on Fiscal Transparency*. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of the questionnaire response and additional information provided by the authorities. The second part is an IMF staff commentary on fiscal transparency in Malawi.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **General government is not clearly defined.** Government policy in Malawi has generally been carried out by the central government and its field administration. At the local government level, a very restricted revenue base has limited the activities of the 39 assemblies. As a reporting entity, the focus is on central government budget sector and there is no reporting on the general government sector. There are a range of quasi-fiscal activities carried out through parastatals as well as extrabudgetary fund operations that are not reported adequately and, from time to time, donors finance activity outside the budget.

3. **The authorities are implementing a substantial decentralization initiative.** This will give operational responsibility for expenditure programs to the assemblies. Policy responsibility will, however, remain with the central government ministries. Some sectoral responsibilities are still being resolved. While the role of the assemblies has not been extensive to date,¹ it is expected that this will increase substantially. Under the initiative, the financing of the assemblies will be predominantly through central government transfers as the assemblies have limited tax powers which are focused on property taxes and licensing activities. The transfers will occur through a combination of unconditional grants² and sector specific grants. The legislation specifies that the Ministers of Finance and Local Government must authorize any borrowing by the district assemblies.

4. **Some central government functions are also carried out through special treasury funds.** There are 16 special treasury funds operating outside the budget with both commercial and development objectives. These funds are established through the Finance and Audit Act 1966 and are under the direction or supervision of the relevant functional ministry. In recent years, the operations of these special treasury funds have not been reported to parliament.

¹ The Ministry of Local Government estimates that less than one percent of government expenditure was channeled through the district assemblies in 2000/01.

² Malawi Decentralisation Policy 1998, p.12. says that at least five percent of national revenue, excluding grants should be transferred from central government. This policy is not included in the Local Government Act.

5. **There are more than 100 parastatals, each with its own legislation, many of which undertake quasi-fiscal activities.** For example, while the Agricultural Development and Marketing Corporation (ADMARC) was established primarily as an agricultural marketing body, its interests now include a large portfolio of commercial enterprises (e.g. a bus company, textile factory and substantial shareholding in a large commercial bank). Line ministries, the Ministry of Statutory Corporations, and sometimes the Ministers themselves, are actively involved in approving the budgets and business plans for the parastatals, where such exist. However, there is no reporting to parliament prior to the start of the year and the relative accountabilities of the responsible ministers and the parastatal boards are not clear. In addition to a large number of publicly owned companies which appear to be inert, there are currently two types of operational parastatals—subvented and ‘commercial’ parastatals. The parastatals have a history of poor financial performance characterized by inadequate tariffs, overstaffing and inefficient debt collection (including arrears from the government sector). While ADMARC will be explicitly compensated for the provision of at least some quasi-fiscal activities in the 2002/03 budget, the process of estimating these costs is not complete. Other commercial parastatals have not been compensated for similar quasi-fiscal objectives. A number of the largest commercial parastatals have sizable foreign currency denominated liabilities—some of these are government guaranteed debts owed directly to creditors, while others are owed to the government, which on lent funds to the parastatals.

6. **Routine financial reporting by the parastatal sector has generally been weak, but has recently improved.** The legislative requirements are generally limited to the preparation of annual accounts and these are not produced on a timely basis. In some cases, the annual accounts are not produced at all. There is limited information provided in the budget, and there is no other performance agreement prepared by the parastatal and provided to parliament prior to the start of the year. The Parastatal Enterprise Reform and Monitoring Unit (PERMU) is charged with responsibility for monitoring financial performance and initiating the reform process in the parastatal sector. At present, it monitors only the 10 largest enterprises and produces quarterly reports based on financial and management accounts for these enterprises. However, the authorities have decided to extend the scope of PERMU’s work to cover all parastatals. Quarterly reports were not being prepared by some parastatals until the Ministry of Finance and Economic Planning (MOFEP) recently requested them to do so. The PERMU has recently been called before the Task Force on Statutory Corporations in the Finance and Budget Committee of Parliament.

7. **There is inadequate disclosure of the financial flows associated with the privatization program.** The Government of Malawi embarked on a privatization program in 1995, starting with commercial enterprises in the manufacturing sector. This has now expanded to include utilities and infrastructure. The privatization process is managed by the Malawi Privatization Commission, which reports to the minister responsible for privatization.³ The Secretary to the Treasury is on the board of the Commission. Prices for

³ The "Public Enterprises (Privatization) Act" took effect in 1996. The Act sets out the objectives and guidelines for the privatization program and establishes the institutional set-up for the execution of the privatization

(continued...)

entities to be privatized are referred to the Office of President and Cabinet to gain approval for privatization transactions. Based on the relevant Act, the government has determined that any privatization proceeds be paid into the Privatization Revenue Account, which exists outside the budget. The Act specifies that funds held in this account may, with the approval of the Minister of Finance (delegated to the Secretary of the Treasury), be used for funding direct costs of the Privatization Commission and the privatization program, restructuring of public enterprises to be privatized (including retrenchment benefits) and the remainder used for development purposes. However, in practice transfers to the account have been executed net of these costs.

8. **Information on all government equity in business is not readily available, especially with regard to minority and subsidiary holdings.** There is no reporting in the budget documents and only financial assets are separately reported in the annual accounts. The authorities now actively pursuing the sale of these investment holdings.

9. **The Reserve Bank of Malawi (RBM)⁴ undertakes a number of quasi-fiscal activities.** The various quasi-fiscal expenditures not directly related to its operational activities include a large computerization project in the banking sector, some limited credit facilities extended to the private sector, and the operational costs of the stock market. While a key objective of the computerization project is to facilitate real time settlement, the scope of the project has been expanded to include the development of a smart card scheme and electronic funds transfer capacity. These activities go beyond the core responsibilities of a central bank and the RBM hopes that at some future date the commercial banks will be in a position to assume ownership of these elements of the system.

10. **There have been a number of special non-transparent financial transactions between the RBM and the Government of Malawi.** The RBM has made various advances to the Government on a concessional or interest free basis. The balance of special loans stayed at MK 1.6 billion for nine months from September 1999 to May 2000, but has been zero since October 2000. The authorities advise that this program has been discontinued. The Malawi Government has issued non-interest bearing promissory notes to the RBM to cover losses. As of December 31, 1999 they amounted to MK 1,165 million, and subsequently increased further to MK 2,128 million at the end of 2001. The Government's accounts do not disclose the stock of these promissory notes although the full value of the notes is included in the RBM balance sheet. Similarly, the issuance of the promissory notes is not reported by the

program. The Privatization Commission is the sole authority in Malawi to implement the privatization of the direct or indirect government ownership of any public enterprise. Membership includes ex-officio representatives of Government, representatives nominated by each political party represented in the National Assembly, a representative nominated by the Malawi Congress of Trade Unions, and members representing professional and commercial business interests.

⁴ The RBM website is <http://www.rbm.malawi.net/>.

Government and because they are non-interest bearing they do not reflect in the Government's annual debt servicing costs.

11. **Government regulation in some parts of the non-bank private sector has been revised recently; many industries remain dominated by very few players.** The Government has established the Malawi Communications Regulatory Authority (MACRA) to cover the telecommunications and postal sectors. There are other regulatory agencies for individual sectors, such as the National Electricity Council for the power sector, and the Petroleum Control Commission for petroleum pricing. While these recent moves have seen the establishment of industry specific agencies, the Government is undertaking a study, with support from the World Bank, looking at the alternative of a multi-sectoral regulatory agency. There is no antitrust legislation.

12. **The fiscal reporting by local government remains extremely weak.** While section 149 of the Constitution requires a consolidated report on local government finances, this report has never been produced. The Ministry of Local Government is working with donors to improve the quality of financial management and reporting at the assembly level. In order to encourage regular monthly reporting the ministry has been withholding monthly cash advances to those assemblies which have not furnished a satisfactory report. It is important to recognize that the process is still at an early stage of development, and the local government sector is still relatively small. The Local Government Finance Committee, a constitutional body, was established in October 2001.

13. **The roles of the executive, legislative and judicial branches are clearly defined in the Constitution.** The executive initiates and is accountable for all spending. The legislature is not allowed to proceed with any "money bills" without the concurrence of the Minister of Finance.⁵ The legislature can also not change the appropriation bill once it has been introduced. Under parliament's standing orders, there are two parliamentary committees involved in the consideration of fiscal information. The Public Accounts Committee considers the annual accounts and other ex post reports, while the Budget and Finance Committee considers the budget and budget update reports. Although in recent years the Budget and Finance Committee has started taking an active role in monitoring the financial performance against the budget, the limited availability of fiscal data has inhibited the effectiveness of this role. The judiciary is independent of the executive and adjudicates cases dealing with financial law including those involving the executive.

14. **Fiscal management is defined by a clear but outdated legal framework that focuses on financial process and compliance rather than transparency.** The Constitution and the Finance and Audit Act 1966 provide the formal framework based on the post-independence Anglophone model. All debt charges and some other statutory payments are directly authorized under the Constitution⁶ while other expenditures are approved annually

⁵ The Constitution of Malawi, section 57.

⁶ The Constitution of Malawi, section 174.

by parliament. The Minister of Finance is responsible for preparing the budget, reporting to parliament and generally managing the country's financial affairs. While the legislation requires that parliamentary approval be sought where any additional expenditure is to occur, in practice only one supplementary budget is prepared late in the fiscal year. While a number of measures have been introduced in recent years that increase transparency, these have been administratively, rather than legislatively, based. Administrative direction occurs through Treasury Instructions (Finance) and Treasury Instructions (Stores), and through Treasury circulars.⁷ The Treasury issues circulars in response to business demands and when necessary to do so. There is a current review of the Finance and Audit Act 1966 and new draft bills now exist for a Public Finance Management Act and Public Audit Act.⁸

15. The Government is making some headway in reducing its presence in the commercial banking sector. Following partial privatization activity, the Government holds minority shares in the two largest commercial banks, with plans for further reduction. In addition, the Government is the sole owner of the smaller Malawi Savings Bank. The Government has also taken action over the past 15 months to remove large line ministry cash deposits from the commercial banking system.⁹ No direct support to these institutions is provided through government guarantee.

16. Flows between the RBM and the Government are regulated formally through the RBM legislation.¹⁰ The legislation limits ways and means advances to 20 percent of domestic revenue. Beyond the limit the Government is expected to finance its operations through issuing debt. However, in 2001/02 the limit was reached and the Government issued treasury bills directly to the RBM to replenish the facility,¹¹ illustrating that advances to Government by the Bank are higher than the ways and means advance suggests. The RBM is required to pay any residual profits to the Government. The profits to be transferred are calculated after available funds are used to build up the reserves of the RBM as specified in the legislation.¹² In 1999 no dividend was paid as the RBM made a loss, and the same was the case in 2000.

⁷ The Treasury Instructions were published in the early 1970s and the booklet has not been comprehensively reviewed since that time.

⁸ As these drafts have not been formally endorsed by Government, they are considered to have no formal standing in the consideration of current practice.

⁹ Prior to this, government deposits reached more than MK 1.6 billion in idle funds at the commercial banks. In the three months prior to the ROSC mission, deposits varied between MK 154 million and MK 514 million.

¹⁰ Reserve Bank of Malawi Act (1989).

¹¹ It appears that the limit was exceeded in four of the five months from December 2001 to April 2002.

¹² Reserve Bank Act, section 54.

17. **The legislative bases for taxation, regulation and administrative procedures are not clear.** Section 86 of the Finance and Audit Act 1966 and Section 52 of the Customs and Excise Act 1989 give the Minister of Finance the discretion to provide exemptions in the “national interest”. The authorities are proposing to improve the transparency with which this discretion is exercised by developing and publishing in the gazette guidelines, which will be used by the Minister. At present, the criteria used for determining the issuance of exemptions is not transparent.

18. **Tax administration is considered to be weak and prone to corruption and tax compliance is low.** In order to improve the quality of staff the Government has increased the Malawi Revenue Authority (MRA)¹³ budget by raising the proportion of tax receipts the MRA can retain from 1.65 percent to 2.5 percent. Donors are also assisting capacity building in the MRA. In addition, the MRA has acted to remove staff involved in irregular financial activities. MOFEP advised that over 20 percent of staff were removed on this basis in 2000/2001. Although general tax compliance is low, the MRA has tended to focus on a small group of large existing taxpayers. To improve taxpayer education, the MRA is intending to disclose tax rulings on the MOFEP website and a quarterly tax bulletin is being released by MOFEP. However, it is acknowledged that further measures are required to improve general taxpayer understanding and compliance.

19. **Public servants are subject to a code of behavior, but the code appears to be enforced weakly.** The conduct and discipline section of the Malawi Public Service Regulations specifies a range of unacceptable behaviors such as using information for personal gain, and engaging in an occupation that might conflict with the interests of government or be inconsistent with his duties.¹⁴ There are a number of other public bodies with a role in promoting good governance. These include the Anti Corruption Bureau, the office of the Director of Public Prosecutions¹⁵ and the Office of the Ombudsman.¹⁶

¹³ There is not a statutory basis to the appointment of the Commissioner General of Revenue. The board of the Authority appoints the Commissioner General and the Government appoints the board members.

¹⁴ Malawi Public Service Regulations 1:201.

¹⁵ Constitution of Malawi, sections 99 – 102; the Director of Public Prosecutions has the authority to decide whether or not to proceed with a criminal case. Appointments to this post are by the President for a five-year term.

¹⁶ Constitution of Malawi, sections 120 – 128; the Ombudsman may investigate any case where a person has suffered an injustice and court proceedings are not appropriate. The Ombudsman is appointed by the Public Appointments Committee and has statutory independence.

B. Public Availability of Information

20. **The budget documents do not provide a comprehensive coverage of fiscal activity.**¹⁷ Detailed local government information is not presented, although transfers from the central government are disclosed as are some expenditures executed at the local level. So far, the self funded activities of the assemblies have been modest without substantial fiscal impact. Further decentralization is planned. There is detailed yet incomplete coverage of central government, with limited disclosure of extra budgetary activities, such as those carried out via the treasury funds. In addition, although the coverage of donor funded activity is increasing, not all donor funded projects are covered as some donors finance projects outside the budget.¹⁸ As development assistance to Malawi is sizable,¹⁹ having a portion of these funds outside the budget can substantially understate the overall public policy effort.

21. **However, there is some very detailed information in the budget documents.** The Estimates present for each line item, the past two years, the budget year, and the coming two years. The line items are organized by sub program and program. The Estimates (output based) provides a high level description of the priority activities in each Vote and an account of the main activities completed in the previous year. The Economic Report has statistical information going back up to 10 years depending on the issue being considered. It generally presents forecasts for the coming year and subsequent two years (although in the 2001/02 budget only the current year information was provided). In the public finance chapter, there is a breakdown of the central government budget by functional and economic classification. A very short description of the performance of the larger Treasury funds and a selection of parastatals is also included in this section. This information is disclosed but is not integrated into the overall fiscal reporting. The Financial Statement provides aggregate expenditure and revenue data by Vote, item, and capital project level. There is also an aggregate comparison of the approved and revised Estimates for the previous year. Detailed domestic and external revenue information is provided by Vote, and detailed yet incomplete information on external resources is provided for each donor. The use of the website to publish fiscal information is in the early stages of development. The website is: <http://www.min-finance.sdnpp.org>.

22. **Information is available on total defense and security expenditure.** While total defense spending is disclosed in the Estimates, the detail is less than for other Votes of a

¹⁷ The Budget documents include the Budget Statement, the Economic Report, the Financial Statement, Draft Estimates of Expenditure (output based), and the Draft Estimates of Expenditure (detailed estimates).

¹⁸ The World Bank reported in *Malawi Public Expenditures*, September 2001, Report No. 22440 MAI, that the education sector had a significant proportion of its funding off budget reflecting the fact that at that time five main donors did not record their expenditures in the development budget.

¹⁹ In 1998 assistance was 26 percent of GDP (Malawi: Selected Issues and Statistical Appendix, IMF, January 2001).

comparable size. In the past only aggregate expenditure has been reported for the National Intelligence Bureau although more information was provided in the 2002/03 Budget.

23. **Statements on contingent liabilities, tax expenditures, and quasi-fiscal activities are not routinely included in the budget documents.** A statement of contingent liabilities is, however, included in the annual accounts.

24. **Information on public debt and financial assets is not published in the budget.** Although debt information is included in the annual accounts, the delay in publishing the accounts reduces the usefulness of this information.²⁰ The coverage of this information is also incomplete. Liabilities created through finance leases and payment arrears are not disclosed. Similarly, there is no information on financial assets in the budget although this information is included as part of a balance sheet in the annual accounts, which presents financial assets and liabilities.

25. **Formal commitments for more regular publication of fiscal data have not yet been made.** Existing financial management legislation makes limited mention of fiscal reporting. Even where the legislation specifies a timeframe for reporting (for example, the presentation of the annual accounts), these requirements are not always being met. The proposed Public Finance Management Bill does however contain extensive reporting requirements. Malawi is one of 14 countries participating in the GDDS Project for Anglophone Africa.

C. Open Budget Preparation, Execution, and Reporting

26. **The annual budget presentation refers to financial compliance, performance and macroeconomic constraints.** Budget classification, but not coverage, is largely consistent with international standards. There is a well developed programme budgeting classification which is also used as the basis for a functional presentation of expenditure. The introduction of the Estimates (Output based) in the 2000/01 budget is a very useful step to introduce performance information, and to provide summary input information by programme in a more digestible form. In 2001, the detailed estimates amounted to five volumes, almost 4500 pages, with the estimates for Vote Agriculture alone at 1330 pages. The 2002/03 detailed estimates have been substantially reduced in volume. The Budget Statement provides a wide ranging commentary on budget policy and performance. The budget timetable is reasonably stable, although subject to compression. In the lead up to the budget, discussions are held with a range of public and private sector bodies. As the authorities do not prepare draft forecasts for these discussions, they are primarily an information gathering exercise rather than a check on the quality of the forecasts. Opportunities for civil society

²⁰ The 1999/2000 accounts were submitted to the Auditor General in 2002.

engagement in resource allocation decisions have increased as a result of the Poverty Reduction Strategy Paper (PRSP) process.

27. **The budget documents focus on the central government budget, and the overall balance of general government is not used as an indicator of the fiscal position.** The presentation separately provides considerable detail on expenditure and revenue projections, but while a budget balance target can be derived from the information provided, the overall balance of central government sector cannot be derived, due to the lack of coverage of some activities referred to above. No other indicators of the fiscal position are presented.

28. **There are no clear fiscal targets stated in the budget documents and the MTEF is still in a state of development.** There are no medium term targets for fiscal policy and the short-term fiscal target is not made explicit. While the MTEF process envisages rolling medium term estimates of revenue and expenditure, in practice each Budget is based on fresh ceilings for each ministry and the revenue forecasts beyond the current year are not considered a sound basis for revised projections.

29. **Estimates of ongoing costs of government policies are not clearly distinguished from new policies in the budget documents.** The budget speech does identify a selection of new policies, but these are not systematically identified and costed in the Budget documents. The PRSP contains estimates for planned spending on poverty reducing programs.

30. **Analysis of the sensitivity of the forecasts to changes in economic parameters is not published and the main fiscal risks are not stated.** A provision is made in the estimates for the possible costs of known legal action against the Government but other contingent liabilities are not disclosed.

31. **Internal control procedures are in place although their effectiveness is variable.** Cash rationing is a prime means of expenditure control. This contributed to a significant accumulation in expenditure arrears prior to 2000.²¹ Over the past year or so there have been substantial changes in the cash management system with the introduction of the credit ceiling authority (CCA) and the commitment control system (CCS). While there have been some teething problems with the new systems the outstanding arrears have been reduced.

32. **The internal audit function is also considered to be weak at present.** The service is decentralized and not well focused. The Office of the President and Cabinet has had the lead on this issue and had been intending to issue guidelines to clarify how the internal audit function should be performed. A major focus was to be on pre-audit (verification of documents). However, a recent report commissioned by the MOFEP has recommended that the focus for internal audit should be systems auditing. With different views being expressed by the two Ministries, the direction for the internal audit service is not resolved.

²¹ As at November 1, 1999 total payment arrears outstanding were MK 980 million, or about 1 percent of GDP.

33. **A new procurement code is being prepared to improve the contracting and procurement process.** Procurement functions in ministries are being performed by internal procurement committees. While it has also been recommended that the procurement process be decentralized, the authorities are proposing to phase the decentralization of procurement to match improvements in the financial administrative capacity of the ministries.

34. **Audited final accounts are not available within six months of the end of the fiscal year.** Fiscal reporting to the public and the legislature is specified in the Finance and Audit Act 1966, but the requirements are limited and the timeframes have not always been met. The Act specifies that the annual accounts be presented to the Auditor General within six months of the end of the year (i.e. before December 31), and that the Auditor General report to parliament, through the Minister of Finance, within a further five months. The Auditor General's reports indicate that the Accountant General's Department has not met the statutory requirement on a single occasion in the past decade.

35. **The accounting system is not yet capable of producing complete and accurate in-year reporting on central government budget operations in a timely way.** While the MOFEP produces quarterly budget tracking reports based on ministries' expenditure returns, these reports focus on the flows in the period and do not present information on other issues such as the debt position. There is no formal mid-year review prepared for the legislature by the executive. Data on project disbursements are likely to underestimate actual disbursements.²²

D. Independent Assurances of Integrity

36. **The budget documentation is not a good guide to the actual fiscal performance of the government.** As a result of the deficiencies in the budget preparation and execution processes, variations in total expenditure have been marked. In addition to the aggregate variations between budget and outturn, there have been substantial variations in the economic and administrative components of expenditure.²³ As mentioned above, expenditure arrears have also been a significant problem. While indicative costs for the next two years are provided in the Estimates documents, an examination of outyear estimates suggests arbitrary costings are made in some circumstances.

37. **There is no statement of accounting policy in the budget and final accounts documents.** The Malawi government accounts are produced on a cash basis, with some additional disclosures relating to some balance sheet items. The new draft Public Finance

²² 14 of the 30 main foreign-donors are considered as not providing regular information on their projects.

²³ The average unweighted variance for all recurrent Votes (actual amount spent compared to budget) was 35 percent through the years 1995/96 to 1997/98, 16 percent in 1998/99, and 30 percent in 1999/2000.

Management Bill proposes the use of generally accepted accounting practice however the intention in the short term is to continue to use cash accounting.

38. The processes of accounts reconciliation and fiscal reporting are not effective.

While regular checks are made to confirm that line item appropriations have not been exceeded, some ministries have an 11-month backlog in bank reconciliations. The reconciliations are the responsibility of the line ministry. The timeliness of bank reconciliations is being improved as preparations are made for the pilot introduction of the IFMIS. No formal reconciliation is made between the debt and deficit data.

39. The Constitution specifies that the Auditor General is independent of the executive branch.

The President makes the appointment for a five-year term although there is an opportunity for the Public Appointments Committee to question the appointment on certain grounds relating to competence and financial probity.²⁴ Once the Committee has considered the proposal it is taken to the National Assembly for final approval. There are also grounds for the appointment to be terminated during the five years.²⁵ At present the Auditor General does not have any financial independence. The Estimates are vetted and controlled by the MOFEP and the Auditor General has to rely on cash releases by the MOFEP. In addition, the employment terms and conditions of audit staff are governed by the standard public sector arrangements. The new draft Public Audit Bill will provide more financial independence to the Auditor General, and increase his duties and powers.

40. Strengthening of audit capacity is required, as high staff turnover has led to a substantial loss in experience.

The authorities expect that the greater remuneration flexibility envisaged by the new Public Audit Bill will assist in improving staff retention. While the focus of the Auditor General is at present on financial audit, the new Bill provides for performance reviews and audits. In addition to its core functions, the Auditor General's office audits the quarterly payment arrears returns furnished by Ministries through the MOFEP.

41. The authorities engage with external agencies in preparing the macroeconomic forecasts.

A committee involving the MOFEP, the RBM, the National Statistics Office (NSO), and the National Economic Council prepares the economic forecasts.

42. The Statistics Act 1967 does not provide the NSO with legislative assurance of independence.

²⁶ The focus of the Act is primarily on the rights of the NSO to access information for statistical purposes, and on the responsibilities of the officers of the NSO in using the information collected.

²⁴ The Constitution, Section 184.

²⁵ The Auditor General can be removed by the President by reason of being incompetent, compromised with respect to financial probity, incapacitated or over retirement age.

²⁶ The website for the NSO is <http://www.nso.malawi.net/>.

43. **Other bodies exist to improve good governance.** In recent years, a number of bodies, independent of the executive, have been created to restrain the exercise of political power. These have included the Anti-Corruption Bureau (established with investigative staff in 1998), and the creation of the office of the Ombudsman (1996). The ACB has been a highly visible vehicle for pursuing issues of corruption, but it has experienced some difficulty in bringing individual corruption cases to a close. In accordance with Section S (1) of the Corrupt Practices Act 1995, the appointments of the Director and the Deputy Director are confirmed by the Public Appointments Committee of parliament. On all matters of policy the Director is subject to the direction or control of the Minister of Justice, but otherwise the Director shall not be subject to the control or direction of any other person in the performance of his professional duties.

III. IMF STAFF COMMENTARY

44. **In recent years, the Malawi Government has made some important moves to improve the quality of public expenditure management.** Significant examples include the introduction of the MTEF budgeting process, the development of a sophisticated expenditure classification system and the imminent rollout of an IFMIS. Although it was not always a principal aim of these initiatives, one of the outcomes has been improved fiscal transparency. The Department for International Development (DFID), the World Bank and the Fund have all been particularly active as providers of technical and related assistance, with DFID focusing on the MTEF, the Bank on the development of IFMIS, and the Fund on aspects of expenditure management and control, including budget classification.

45. **However, the reform agenda has been uneven and there has been insufficient emphasis on improving the quality and timeliness of data.** There are a number of areas where increased transparency would be of benefit spanning budget preparation, execution and reporting. Even where fiscal transparency is mandated, significant weaknesses in the quality of internal control and formal recording systems have meant that the basic data quality is poor and the information is not released on a timely basis. These problems in budget execution and (*ex post*) reporting undermine some of the usefulness of recent efforts to improve budget preparation and presentation.

46. **In the short term there are some key areas where improvements are required.** In many of these areas work is already underway with the support of donors, and the task is to ensure that there is a fiscal transparency focus to the work. The priorities are:

- **Improving the reporting of fiscal information to parliament.** There are some significant gaps in the coverage and format of current fiscal reporting to parliament. There is an urgent need to provide parliament with comprehensive information on the total operations of the consolidated central government including all extrabudgetary and donor activity. Some information is included solely in the annual accounts, and as a result is not provided in a timely manner while other important information is not provided at all. Extending the information made available to parliament will promote more informed fiscal debate. In the short term priority should be given to including in the budget documents material that is already provided in the annual accounts.

Examples include:

- A summary table of the central government's overall fiscal position;
- Information on public debt and financial assets; and
- Information on contingent liabilities.

Where systems improvements are required to ensure that the information is reliably available, increased reporting should be introduced over time. Examples include:

- Incorporating the financial performance of parastatals and extrabudgetary funds in the general budget analysis;
- Clearly distinguishing changes in policy from existing activities;
- Making regular reports on tax expenditures;
- Producing annual accounting reports in a timely fashion and improving the quality of monthly reports;
- Providing the legislature with a midyear review of budget operations; and
- Conducting an analysis of the sensitivity of the fiscal forecasts to key economic variables.

The increased fiscal reporting would add to the large volumes of information already being provided to parliament. To ensure that this information can be effectively used there will be a simultaneous effort to rationalize the suite of budget documents. Much of the Estimates information in particular is necessary for compliance purposes only. The budget documents should be organized so that the key fiscal information is provided in a simple document and separated from the compliance material.

- **Improving the legislative framework.** Although being overly specific in legislative requirements can reduce flexibility, the present lack of statutory backing poses a risk to recent and proposed initiatives to improve fiscal transparency. The current review of the Finance and Audit Act 1966 provides an opportunity to improve the legislative framework for public expenditure management. From a transparency perspective this means giving legislative backing to some of the initiatives of recent years (such as quarterly reports) and looking to mandate the reporting of key fiscal information not currently provided.
- **Improving the quality of fiscal data.** While the introduction of IFMIS has the potential to improve the quality of fiscal data, this will only be realized if the internal controls and formal recording systems are properly maintained. Responsibility for these systems rests with the Controlling Officer of each functional ministry. In the short term the MOFEP should:
 - Give priority to ensuring that the introduction of IFMIS is successful.
 - Work with the Office of the President to establish a clear approach to the internal audit activity, preferably through mandating MOFEP to take lead responsibility.
 - Clarify its expectations of each Controlling Officer in controlling, monitoring and reporting on the use of resources in their ministry.

Over time the MOFEP should:

- Develop systematic processes for monitoring compliance by the functional ministry with the expectations outlined above; and
 - Be active in responding to the performance of line Ministries with rewards and sanctions.
- **Improving the transparency of the privatization process.** Some basic principles of public financial management should be re-asserted. In particular privatization proceeds should be recorded on a gross basis, and costs associated with privatizations should be explicitly detailed.
 - **Improving the budget preparation process.** A good quality budget has realistic assumptions and costs, and full political support. Recent budgets have not achieved this objective. In reviewing the operation of the MTEF budget process, the authorities should focus on ensuring that sufficient time is provided for each task, relevant information is available for decision-making, and that those with a direct interest are given an opportunity to contribute and therefore own the final product. In the short-term priority should be given to making the macroeconomic forecasting process more open and the reporting more transparent. Over time the authorities should look to introduce the features of a full MTEF process.
 - **Improving the fiscal transparency of the assemblies.** The current weakness of financial management in the assemblies is a concern. Although there is already a donor supported effort to raise financial management capability at the assemblies, this will take time to achieve. The speed with which the decentralization process is implemented should be phased to match improvements in financial management capability in the assemblies.

47. **The short-term initiatives are largely the developments of existing donor-supported activities.** Ensuring that these initiatives are successfully introduced is a priority. Consistent with this objective, in the medium term priority should be given to the following additional measures:

- **Reducing the quasi-fiscal activities of parastatals and making the cost of the remaining activities transparent.** While the privatization process should be a priority, parastatals that remain should have clear commercial objectives and be explicitly subsidized for any quasi-fiscal activities. The authorities should also introduce more explicit reporting to parliament on the operations of parastatals. In particular, parastatals should be required to report at the beginning of the year on their corporate intentions and financial projections in a form that allows monitoring of their performance over the year.

- **Ceasing the quasi-fiscal activities of the RBM.** This will require a careful review of the RBM's activities to determine which activities are necessary for the achievement of its core monetary objectives, and which activities may substitute for direct government action in pursuit of other objectives.
- **Making tax legislation and administration more transparent.** A tax system that is clearly understood and administered will achieve higher levels of voluntary compliance and impose lower economic costs.